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URUGUAY ROUND

Further Papers on Selected Issues

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Explanatory Notes

- References in the text and tables to "countries" are to countries, territories or areas as appropriate.
- The term "dollar" ($) refers to United States dollars, unless otherwise stated.
- The term "billion" signifies 1,000 million.
- Annual rates of growth and change refer to compound rates.
- Exports are valued f.o.b. and imports c.i.f., unless otherwise specified.
- Use of a hyphen (-) between representing years, e.g. 1965-1966, signifies the full period involved, including the initial and final years.
- An oblique stroke (/) between two years, e.g. 1980/81, signifies a fiscal or crop year.
- A dash (-) or a zero sign (0) indicates that the amount is nil or negligible.
- A plus sign (+) before a figure indicates an increase; a minus sign (-) before a figure indicates a decrease.
- Details and percentages do not necessarily add up to totals, owing to rounding.

Abbreviations

ACP	African, Caribbean and Pacific Countries, members of the Lomé Convention
AMS	aggegate measure of support
ASEAN	Association of South East Asian Nations
BIT	bilateral investment treaty
BOP	balance of payments
CAB	Civil Aeronautics Board
CACM	Central American Common Market
CBI	Caribbean Basin Initiative
CCITT	International Consultative Committee on Telephone and Telegraph
CEPT	Conference of Postal and Telecommunications Administrations
c.i.f.	cost, insurance and freight
CRS	Computerized Reservation System
CVD	countervailing duty
DOD	Department of Defense
DPMP	dominant position of market power
EC	European Community
ECU	European currency unit
EEC	European Economic Community
EFTA	European Free Trade Association
FDI	foreign direct investment
FIRA	Foreign Investment Review Act
f.o.b.	free on board
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GNP	gross national product
GNS	Group of Negotiations on Services
GSP	generalized system of preferences
HS	Harmonized System
IGE	Intergovernmental Group of Experts

IMF	International Monetary Fund
IPR	intellectual property right
LBO	leveraged buy-outs
MFA	Multifibre Arrangement
MFN	most favoured nation
MTNs	multilateral trade negotiations
NCPI	New Commercial Policy Instrument
NIE	newly industrialized economy
OECD	Organisation for Economic Co-operation and Development
OFTEL	Office of Telecommunications
PSE	producer subsidy equivalent
PTT	Post Telegraph Telephone
RBP	restrictive business practice
SMU	support measurement unit
SYE	square yard equivalent
TNC	transnational corporation
TRIMs	trade-related investment measures
TRIPs	trade-related aspects of intellectual property rights
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
UNDP	United Nations Development Programme
UR	Uruguay Round
USITC	United States International Trade Commission
USTR	United States Trade Representative
VRA	voluntary restraint arrangement
WIPO	World Intellectual Property Organization

FOREWORD

The Uruguay Round has provided an opportunity for reconsidering the structure and functioning of the multilateral trading system in a variety of aspects. Aiming at a wide-ranging and diversified restructuring of the international trading system, the negotiations have attempted to reform existing General Agreement disciplines on a number of traditional issues as well as to introduce a variety of "new" issues into the range of multilateral agreement, such as trade-related investment measures, trade in services, and trade-related aspects of intellectual property rights. From the perspective of development, the negotiations present an opportunity for integrating the development dimension more adequately into the trading system as well as into trade rules. This involves a better recognition of the needs of developing countries in the existing disciplines, and the formulation of framework agreements on new issues which adequately reflect these needs.

Ever since its formation, the major concerns of UNCTAD have been the relations between international trade and development; its aim has been the greater participation of developing countries in trade, leading to more equitable resource allocation, wider development, and better standards of living world-wide. It is with this objective that UNCTAD has approached the multilateral trade negotiations. In the Tokyo Round, it made a significant contribution to the process of negotiations. Based on the mandate given in the final act of UNCTAD VII, it has been involved with the Uruguay Round as well, aiming to provide technical assistance to developing countries to enable them to participate more effectively in the negotiations. With the financial assistance of the United Nations Development Programme, UNCTAD has launched three regional projects and one interregional project for this purpose.

As part of these projects of technical assistance, UNCTAD has prepared a number of studies on several important issues in the Round, aimed at helping developing countries to identify their objectives better in relation to the negotiations. Some of these papers were published last year in the volume *Uruguay Round: Papers on Selected Issues*. The present publication forms a sequel to this. Along with the many other UNCTAD publications in the context of the Uruguay Round, it examines a number of specific issues in detail. The papers have been prepared by members of the UNCTAD secretariat and by consultants. It is hoped that the wider circulation of these papers is useful for all interested in the Uruguay Round and in questions of development.

INTRODUCTION

B.L. Das[*]

The Uruguay Round of multilateral trade negotiations has entered its final year, and the concluding meeting has been scheduled to take place in Brussels in December 1990. While bringing out the first collection of papers on selected issues in the Uruguay Round, we observed that the present Round is "the most challenging undertaking in GATT history", not only because of the worsening of the world trading conditions, but also due to its complex and diversified agenda. The Uruguay Round, in many ways the most ambitious attempt to restructure the multilateral trading system, has brought into the negotiating ambit a number of new issues previously not focused on by MTNs. These include trade-related investment measures, trade in services and trade-related aspects of intellectual property rights.

The UNCTAD, in a number of documents examining in detail some crucial aspects of the issues addressed by the negotiations, has noted the unique opportunity and challenge presented by the Uruguay Round in relation to questions of development. In a trading environment characterized by increasing bilateral measures, the Round can function correctively by reaffirming non-discrimination and genuine multilateralism, thus preventing welfare losses to weaker trading partners. Furthermore, the Uruguay Round presents an opportunity for decisively incorporating the "development dimension" into the multilateral trading system so that undistorted trade can aid the development of developing countries and can result in better conditions of living for peoples all over the world.

However, it needs to be mentioned that the progress of the negotiations in the Uruguay Round has been uneven from the perspective of the points mentioned above. On the "new issues", the pace of negotiations has continued to accelerate, while negotiations on traditional market access issues have been rather slow, though lately there have been some signs of increased momentum in these areas. The negotiations have been characterized by the predominance of north-south issues, questions on which the interests and positions of the developed and the developing countries substantially differ. Given the potential impact of some developed-country proposals and the intensity of bilateral pressures, it is becoming increasingly difficult to envisage the emergence of a package which will prove adequate to the actual needs of developing countries.

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In this context, it is all the more necessary to examine the various aspects of the issues involved in the Uruguay Round and whether the proposed attempt at the restructuring of the trading system will result in facilitating the development of developing countries. The consequences of the various attempts at trade liberalization need to be examined in this light. Similarly, it needs to be considered what specific measures could improve market access for products from developing countries, ensuring a more balanced trade and welfare situation.

The UNCTAD, in collaboration with UNDP, has organized three regional projects and one interregional project to provide technical assistance to developing countries and to facilitate the latter's effective participation in the negotiations. Several studies, examining various aspects of the Round and the implications of many of the negotiating issues for questions of development, have already been published. A number of publications, throwing further light on specific sectors and regions, is currently under preparation.

The present volume is a selection of papers prepared by the UNCTAD staff members as well as by consultants on some of the major issues. It forms a sequel to *Uruguay Round: Papers on Selected Issues*, published last year. The papers can be seen as belonging to two groups. The first group addresses issues directly related to the Uruguay Round of trade negotiations. The range of issues examined here extends from the reforming of General Agreement articles on trade in agriculture to the "new issues" such as trade-related aspects of intellectual property rights, trade in services, and trade-related investment measures. The second group considers a set of issues which are relevant in the context of the multilateral trading system. The implications of some of the regional integration measures by developed countries - e.g. EC and United States-Canada Free Trade Agreement - for third countries are examined.

Rosine Plank, in her paper on the proposals for reforming General Agreement rules on agriculture, argues that the agenda of the Uruguay Round negotiations on agriculture was mainly motivated by the increased costs of farm support among the developed countries and the competition to dispose of food surpluses. The paper analyses in detail the various proposals made in the negotiating group, concerning a number of crucial issues such as internal support, import access, export restrictions, and special and differential treatment of developing countries. The paper argues that there is a compelling need for many developing countries to increase their productivity and therefore to provide producer support. Many developing countries have argued that measures applied by them to increase productivity, stabilize prices and supplies, or subsidize consumers should not be included among the trade-distorting measures to be reduced or eliminated. There is also a need for an improved contractual basis for access for developing-country agricultural products to developed-country markets. Reciprocal commitments by developing countries under a reformed agreement must be conditional on tangible benefits they receive in terms of new marketing opportunities and suitable compensation for losses for preferential margins or shares, if any. It would also be useful to improve the contractual basis under which food aid is accorded, and to secure a level that adequately corresponds to the immediate dietary needs and long-term development plans of developing countries. The paper cautions that there is a danger that too much emphasis on food security and non-trade concerns may be used by developed countries to justify limiting further market access opportunities to developing countries. In relation to export restrictions, Plank suggests that article XI:2(a) should be retained for developing countries, since they have less purchasing power than developed countries to ensure adequate food supplies. While considering the options and modalities for special and differential treatment, the paper argues that any long-term reform in agricultural trade should take adequate account of the specific needs of net food-importing countries, particularly the least-developed countries. Appropriate compensation and other measures should be provided for the high food costs of these countries and for enhancing their capacity to increase agricultural production.

In their paper, Hardeep Puri and Delfino Bondad analyse the negotiations on TRIMs in relation to the submissions made in the Uruguay Round Negotiations and to the development policies of developing countries. They argue that, contrary to what has been suggested by some contracting parties, there is no presumption in the Punta del Este mandate and in the Mid-Term Review Decision that investment-measures have trade-distorting effects *per se*. Many developing countries impose TRIMs to attract foreign direct investment and to regulate such incoming investment. Furthermore, investment measures are part of the strategies a developing country has for dealing with the restrictive and trade-distorting practices of transnational corporations. Therefore, TRIMs are intimately related to their development policy, foreign exchange policy and balance-of-payments policy. The authors argue that these considerations need to be integrated into the negotiating process. Puri and Bondad examine some articles of the General Agreement that have been invoked during the negotiations on TRIMs. They argue that the General Agreement, as presently drafted, concerns international trade on *goods*, and not investment. The discussions on the applicability of specific articles of the Agreement to TRIMs need to be viewed in this light. While analysing a number of such articles, they argue that investment measures imposed by governments do not fall under article I, since this article deals with discriminatory measures rather than effects and also because TRIMs are not border measures. Articles II, III, VI, VIII, X, XI, XVI, XVII, XVIII, and XXIII are also examined in detail in the paper. The authors argue that prohibiting the use of investment measures for development purposes will be tantamount to upsetting the rights and obligations of less developed contracting parties under the General Agreement. If the investment measures of developing countries have direct and significant adverse effects on trade, the existing provisions of the General Agreement should be used for remedying them rather than the Agreement itself being changed to accommodate a desire to promote wider and freer investment opportunities.

The paper by the VanGrasstek Communications presents a theoretical analysis of the TRIPs issue and of the United States position, with particular emphasis on the importance of the issue for developing countries. The paper argues that countries gravitate towards stricter enforcement of intellectual property rights as their economies become more sophisticated. However, this process may not be as rapid as their trading partners will prefer. This difference of opinion, the authors argue, may lead the more advanced countries to put pressure on the mid-level countries. This explains why this issue has become of particular concern to the United States, why the Unitd States complaints tend to concentrate on the more advanced among the developing countries, and why the United States has threatened to use commercial retaliation as leverage in these disputes. The paper further discusses the various mechanisms available to the United States negotiators on TRIPs. They include unilateral enforcement, bilateral negotiations, conditionality in trade preferences and, above all, Section 301, Super 301, and Special 301 retaliatory instruments. In conclusion, the paper reviews the the United States goals in the TRIPs negotiations, and underlies the gulf that remains between the United States demands and the actual achievements in the talks.

The paper by Philippe Brusick, Murray Gibbs and Mina Mashayekhi discusses the nature and impact of important restrictive business practices of transnational corporations in the service sector, and argues that for developing countries, as new entrants in many sectors, RBPs represent an extremely threatening unilateral measure with serious trade impact. After briefly reviewing the history of attempts to regulate RBPs, the paper identifies four main kinds of RBPs that are addressed by competition laws: These are (a) conspiracy between firms to eliminate competition by reaching agreements with competitors to fix prices and allocate markets, (b) use of measures such as refusal to deal, tied selling, and predatory pricing, (c) efforts to acquire a dominant position of market power through takeovers, mergers and acquisitions, and (d) attempts to dominate markets through control of technology. The paper examines a number of examples of RBPs in various service sectors such as insurance, banking and financial services, transportation, and advertising. In the context of the internationalization of service markets, the authors argue that this process will inevitably bring RBPs by service industries to the forefront, rendering access to certain markets extremely difficult for outsiders in specific regions or where cartel arrangements might entrench local companies. They further point out that given the strategic role of the service sector in the production/distribution chain, the distortions in service markets caused by RBPs will have damaging consequences for many other markets. In relation to the Uruguay Round negotiations on trade in services, the authors argue that to be meaningful, any agreed provisions on transparency, market access and the greater participation of developing countries, must seriously address the RBP element. In addition to traditional forms of RBPs, action at multilateral level needs to address RBPs related to the control of technology, dumping, the use of "networking" to restrict access and to create captive suppliers and clients, and certain activities of private associations which have trade-distorting effects. The authors emphasize the need for a multilateral framework with rights and obligations, with respect to the control of RBPs and their effects.

Andrew Cornford's paper considers a specific area within the services sector - banking services - in the light of the Uruguay Round attempt at evolving a multilateral framework on trade in services. The author argues that the impetus for a framework agreement in banking services mainly comes from some OECD countries, whose banks have clearly a competitive edge based on factors such as a wider mastery of banking technique and the relevant advanced technology, economies of scope, superior access to information and to currencies used in international trade, greater capacity for innovation, and stronger links to the suppliers of other services. Considering the benefits and costs of a more liberal regime for international trade in banking services, the author argues that the claimed benefits mainly spring from increased competition and transfer of skills. However, many developing countries consider the expansion of their indigenous banking sectors an integral part of successful development, and are apprehensive about the impact of a liberal regime. Questions related to governability - including those posed by the capacity of transnational banks to evade taxes, to facilitate capital flights or to conceal aspects of their operations from developed country regulatory authorities - also add to their concerns. Another apprehension is with respect to the strength of foreign banks that enable them to squeeze or stifle indigenous competitors through price discrimination between markets in different countries. The author examines the concepts and principles elaborated in the Mid-Term Review

Decision in relation to a possible multilateral framework in banking services. He argues that "market access" control is the policy instrument perhaps most crucial in enabling developing countries to choose the banking regime which they believe to be most appropriate to their specific circumstances and needs. Provisions for the exchange of information among supervisory authorities of parties to an agreement may allay some of the apprehensions in developing countries in relation to governability. Cornford also points out that a multilateral agreement in banking should address the subject of impediments to developing-country access to banking markets in developed market-economy countries.

Edmond McGovern, in his paper, discusses the prominent features of the anti-dumping law and practices of the European Community, emphasizing aspects which are of special interest to exporters from developing countries. He discusses the investigation procedure, the calculation of the margin of dumping and of anti-dumping duty, and the procedures of review and refund. The paper further examines whether these are compatible with the General Agreement on Tariffs and Trade. In the only complaint that has come up before a GATT panel against EC's anti-dumping law, the panel decided against the community. Though the explicit rules of the General Agreement are not apparently violated by much of the Community law, the author argues that, to decide the question of compatibility, one also needs to take into account the rules implied by the explicit rules in the Anti-Dumping Code. McGovern also examines some specific features of the Community law that have given rise to criticism. These include the inadequate time-limit given to exporters to answer questionnaires and the delays in the Commission's decision making and review; the procedures for constructing prices; the "zeroing down" of the negative dumping margins; the cumulation of imports from different countries, etc. The author argues that in many of these cases the Community law may appear to be unfair. So far, Japan has been affected most by the law. However, more developing countries, especially the newly industrialized countries in South-East Asia, could become its target, especially after the proposal to remove the multi-fibre arrangement is put into effect. Article 13 of the Anti-Dumping Code of the General Agreement provides for the special treatment of developing countries. One way in which this can be translated into actual practice will be by excluding developing countries from cumulation while determining injury.

Rodney de C. Grey's paper comments on the proposals advanced in the Uruguay Round negotiations on trade-related investment measures, focusing on the European Community's "1992" project and on how this may shape EC's policy on TRIMs. The author argues that EC will remain primarily concerned with reducing the use of subsidies and other incentives for foreign direct investment by member States. However, between EC as an entity and other countries, the Community is not likely to accept obligations that would limit the ability of its member States to influence the conduct of foreign-controlled corporations. Grey examines the various proposals made by EC in the Uruguay Round, related to local content requirements, domestic sales requirements, export performance requirements, etc. He argues that it is unlikely that EC could contemplate completely abandoning the use of content criteria and that, given the size of the EC market, export performance requirements are not likely to be employed by EC, thus placing the Community under no disability in wishing to preclude others from imposing such conditions on EC investors. While discussing other relevant issues related to TRIMs, the author notes the argument of some developing countries that governments need rights to impose conditions on FDIs because there is no international legal system which inhibits TNCs from indulging in restrictive business practices at the expense of host countries. The Commission of the EC has an active competition policy which, in the absence of an international system, can achieve some of the objectives of TRIMs. However, as a practical matter, few countries have the option of using competition law to discipline foreign firms. Grey argues that to the extent that developing countries, particularly those in Asia which are having fast growth, may develop lines of production in which subsidiary operations in the EC become attractive, they will become subject to EC TRIMs, especially the local content requirements. The major options for developing countries in relation to TRIMs would be either to rely on the special provisions of the General Agreement, such as article XVIII, or to seek a "reciprocity" rider that provides that a developing country may impose such TRIMs as are employed in the home country of the foreign direct investor.

The paper by Peter Clark and Peter Burn examines the Canada-United States Free Trade Agreement and its implications for third countries, particularly developing countries. After providing a synopsis of the various articles of the Agreement, the paper considers the trading relationship between the two countries, and notes that the FTA is a legalization of an increasing integration between the countries since 1960. The authors argue that the impact of the FTA on the United States economy will be negligible and that it will be in the Canadian economy that its effects, both positive and negative, will be most felt. They further argue that the FTA is clearly designed to promote the competitiveness of North American firms vis-à-vis third-country competition: it creates a preferential tariff advatage for Canadian and United States firms against third-country firms and will make the red tape of border crossings unravel. Clark and Burn argue that the FTA is designed to encourage direct investment rather than exports to North America. It also lessens the need to avoid the erection of NTBs to cross-border trade by increasing the ability of each party to exempt the other from global actions. All these aspects have their implications for third countries, especially developing countries.

The papers in this volume emphasize the need to integrate the development dimension adequately into the international trading system. Analysing a wide range of issues in the Uruguay Round, the authors identify the specific means by which this concept can be translated into operationally effective measures beneficial to the developing countries. I hope that this volume is helpful not only for economists and policymakers, but for all who are concerned with questions of development, and of its integration into international trade.

PART ONE

ISSUES IN THE URUGUAY ROUND

PROPOSALS FOR REFORMING GATT RULES AND DISCIPLINES ON AGRICULTURE IN THE URUGUAY ROUND: IMPLICATIONS FOR AND NEEDS OF DEVELOPING COUNTRIES

Rosine M. Plank[*]

> Why is the earth on which we live divided into zones and climates? Why, I ask, do different countries yield different productions to people experiencing similar wants? Why are lands the most distant from each other, brought almost into contact by the very ocean which seems to divide them? Why, Sir, it is that man may be dependent upon man. It is that the exchange of commodities may be accompanied by the extension and diffusion of knowledge. . . multiplying and confirming friendly relations. It is that commerce may freely go forth lending civilization with one hand, and peace with the other, to render mankind happier, wiser, better.
>
> - Lord Palmerston during the debate on the Corn Laws before the House of Commons, 1842.

INTRODUCTION

Few observers of the world agricultural trading market would consider its current state as being the reflection of a naturally-endowed order, as posited above. Most would rather view it as largely determined by the effects of governmental incentives and disincentives on producers and traders. All governments intervene in one way or another within their agricultural sectors. Some forms of intervention, like import barriers or export subsidies, affect trade directly, but other forms that influence domestic production and demand can do so indirectly. Governments intervene in various forms to carry out domestic policy objectives. Industrialized countries, for example, use direct budgetary outlays and border measures to support farmers' income or assure price stabilization. In simplified terms, the net balance of transfers to and from agricultural sectors is such that developed countries generally subsidize their agricultural producers at the expense of their consumers and taxpayers. Developing countries, on the other hand, generally tax their farmers, to provide cheap food for their consumers and to secure fiscal revenues for economic development.[1]

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[*] The author is a consultant to UNCTAD.

Developed market-economy countries dominate world trade in agricultural products. They switched from being a net-importing region to a net-exporting one, largely as a result of output-based support policies and productivity increases, which led to surpluses and their subsidized disposal on world markets.[2] The increasing costs of farm support and competition to dispose of surpluses provided the catalyst for, and largely set the agenda of, the current Uruguay Round as regards agriculture.

The Punta del Este Ministerial Declaration which launched the Round in 1986, defined the goals of the agricultural negotiations as

> to achieve greater liberalization of trade in agriculture, and bring all measures affecting import access and export competition under strengthened and more operationally effective GATT rules and disciplines . . .

The Mid-Term Review Agreement of April 1989 set the parameters for the subsequent negotiating process, slated to be completed by the end of 1990. It was stated in this agreement that there was

> a broad measure of consensus that agricultural policies should be more responsive to international market signals in order to meet the objective of liberalization of international trade and that support and protection should be progressively reduced and provided in a less trade-distorting manner.

Ministers agreed that:

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[1] World Bank, *World Development Report 1986* (New York, Oxford University Press, 1987).

[2] For an analysis of world production and trade in agricultural products, see Harmon Thomas, "Agriculture in the Uruguay Round: Interests and Issues", in *Uruguay Round: Papers on Selected Issues* (United Nations Publication, UNCTAD ITP 10), pp. 221-60.

> the long-term objective of the agricultural negotiations is to establish a fair and market-oriented agricultural trading system and that a reform process should be initiated through the negotiation of commitments on support and protection and through the establishment of strengthened and more operationally effective GATT rules and disciplines.

This marked a significant movement from the original negotiating mandate of achieving trade liberalization, toward disciplining the form and degree of government intervention.

Ministers also stated under the Mid-Term Review Agreement, that "the particular needs and conditions of developing countries should be fully taken into account at all stages of the negotiations." Ministers agreed that special and differential treatment to developing countries was "an integral element of the negotiations", particularly as regards new rules and disciplines. They recognized that government assistance to encourage agricultural and rural development was "an integral part of the development programmes of developing countries". Ministers also agreed that "ways should be developed to take into account the possible negative effects of the reform process on net food-importing developing countries".

This paper attempts to analyse the proposals for reforming the General Agreement rules and disciplines on agriculture in the Uruguay Round, against the backdrop of provisions in the Agreement, in order to (a) highlight the implications thereof on the development needs and prospects of developing countries, and (b) develop options on modalities for special and differential treatment for developing countries.

Section I will describe some of the main options being considered in the Negotiating Group on Agriculture for reforming GATT rules and disciplines on agriculture, and analyse their implications for developing countries. Section II considers possible modalities for special and differential treatment for developing countries emerging from section I. Section III provides some concluding remarks with respect to assuring that the final agricultural reform package serves the needs of the developing countries.

I. PROPOSALS FOR REFORMING GATT RULES AND DISCIPLINES ON AGRICULTURE: GENERAL OPTIONS BY NEGOTIATING ISSUES AND THEIR IMPLICATIONS FOR DEVELOPING COUNTRIES

There is no definition of the term "agriculture" under the General Agreement. Article XI:2 (a) refers to export prohibitions or restrictions to relieve critical shortages of "foodstuffs". Article XI:2 (c) refers to "import restrictions on any agricultural or fisheries product, imported in any form", which according to the Interpretative Note thereto would encompass the fresh product and "the same products when in an early stage of processing and still perishable, which compete directly with the fresh product and if freely imported would tend to make the restriction on the fresh product ineffective". Article XVI:3 refers to export subsidies on "primary products" which are defined in the Interpretative Note thereto as "any product of farm, forestry or fishery, or any mineral, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade". Article XX (b) refers to measures necessary to protect "human, animal or plant life or health". Article XX (h) refers to any intergovernmental agreement on a "commodity".

The above-cited provisions of the General Agreement are among those being reviewed by the Negotiating Group on Agriculture, as part of its mandate to achieve greater liberalization of trade in agriculture and bring all measures affecting import access and export competition under strengthened and more operationally effective General Agreement rules and disciplines. Most of the other 14 negotiating groups under the Uruguay Round are also treating issues which have implications for agricultural trade and their respective mandates overlap to various extents that of the Negotiating Group on Agriculture; especially, of course, the Negotiating Group on Tropical Products and the one on Natural Resource-Based Products.

For the purposes of negotiations, agricultural products are by and large deemed to be those falling within Chapters 1 to 24 of the Common Customs Classification Nomenclature (now the Harmonized System), with participants free to indicate differences between this definition and their own. The United States in its recent proposal to the Negotiating Group on Agriculture, for example, included many other products such as casein, skins, wood, wool and cotton in its definition, and excluded manufactured tobacco.

The proceedings in the Negotiating Group on Agriculture essentially revolve around determining the proper form and degree of government intervention in the agricultural sector. There is an implicit premise that all support affects production and trade directly or indirectly, and implies costs which can be measured. However, what remains to be agreed on is which support measures should be reduced or otherwise disciplined, and how.

The following section highlights some of the main options proposed for reforming GATT rules and disciplines on agriculture, according to the various negotiating issues. It is not intended to provide a comprehensive description of all the numerous proposals or submissions on the negotiating table, but an overview of key ideas and positions. Any summary of this kind must be necessarily selective. An attempt has been made to make it accurate and sufficiently detailed to fulfil the purposes of the study. The organization of the negotiating issues follows the general work programme of the Negotiating Group on Agriculture. The issues are interrelated, and often overlap. The question of the appropriate treatment for developing countries is implicit in all the negotiating topics. An analysis of the implications for developing countries is given after the description of the options under each negotiating issue.

A. Internal support

The fundamental questions being negotiated in relation to domestic agricultural support are: which forms of governmental subsidies should be reduced and perhaps eventually eliminated; and in what terms will the reduction commitments be formulated. At issue is the extent to which governments will be compelled to support their agricultural sectors through methods de-coupled from production or trade effects, or whether they will maintain a certain flexibility in their policy mix even as they eventually bring down support levels.

Essentially two major approaches for disciplines on internal support have been suggested. One is advanced by the United States and the Cairns Group (Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Hungary, Indonesia, Malaysia, New Zealand, the Philippines, Thailand, and Uruguay). This option would phase out specific policies and measures. The other option is by the European Community. It would reduce support levels, but preserve the choice of policy instruments available to governments to support the farm sector. Other proposals basically involve variations of the two approaches.

1. Policy-specific reduction

The United States would group all domestic policies into three categories:

- those to be phased out ("red light");
- those to be disciplined ("yellow light"); and
- those to be permitted ("green light").

The policies in all three categories would be identified in individual country plans submitted to the GATT.

The United States suggests including in the *red* category the following policies directly tied to production or prices:

- administered price policies designed to result in domestic prices higher than prevailing world market prices;
- income support policies linked to production or marketing;
- subsidies on inputs or investment not provided to producers or processors on an equal basis;
- marketing or transportation subsidies other than (green) permitted policies.

Each country would reduce support provided under the above policies relative to the levels prevailing during the (1986-1988) base period, either in terms of budgetary outlays or administered prices or financial costs. The reductions would take place in equal annual steps over the transition period, to be phased out at the end. Policies and mechanisms to meet reduction commitments would be included in individual country plans. Countries would thus be encouraged to shift support to green or yellow policies.

The United States suggests including the following policies, which it considers as minimally trade-distorting, in the *green* category:

- income support policies not linked to production or marketing;
- environmental and conservation programmes;
- disaster assistance;
- domestic food aid;
- marketing programmes, market information, market promotion, inspection and grading;
- general research, extension and education services;
- resource retirement to facilitate transition;
- stockpiling food reserves that do not provide direct price or income support or subsidized inputs to producers, processors, or consumers.

These green or permitted policies would be exempt from reduction.

The United States sees the *yellow* category as largely residual, consisting of all other policies, which are not listed under either the red or green category. The United States suggests including the following production input and capital investment subsidies, generally available to the agricultural sector, in the *yellow* category:

- preferential pricing arrangements for physical inputs such as irrigation, fertilizer, breeding stock, seed production and fuel;

- direct grants of physical inputs;
- financial grants for the purchase of inputs, breeding stock, or perennial stock; and
- government provision of subsidized loans such as long-term loans, low interest rates, loan guarantees, debt or interest-rate forgiveness.

For the United States, input and investment subsidies which are provided without specifying the beneficiary commodities, or which do not require the production of specific commodities, would be included in the yellow category to be disciplined. Product-specific input or investment subsidies would belong in the red category, to be phased out.

The policies in the yellow category would be subject to discipline via a negotiated level of linear cuts, expressed in terms of an aggregate measure of support (AMS). The base year for AMS commitments would be 1986-1988. The policies covered under the AMS would be identified. The AMS would be bound, and the individual policy commitments to meet the AMS targets on an annual basis would also be bound.

Whereas the United States only envisages the AMS as a vehicle for support reduction for policies under the yellow category, the Cairns Group would use a comprehensive AMS for monitoring the total value of all policies (including permitted policies), and a more selective AMS (including market price support and direct payments) for reduction commitments on trade-distorting policies. The Cairns Group basically supports the three category approach, but would include non-commodity-specific aid for infrastructure development under permitted measures.

2. General reduction

The European Community proposes that agricultural support levels be bound under the GATT, with reference to a Support Measurement Unit (SMU). The SMU is based on the Producer Subsidy Equivalent (PSE), as developed by the OECD. The PSE is an index of the income benefit that producers derive from policies. It includes government budget outlays and other financial benefits to farmers, such as those derived from restrictive border measures. These are calculated as the difference between domestic farm-gate prices and representative world market prices. The SMU is the PSE, adjusted by:

- excluding payments which represent a direct and immediate compensation for the reduction of the use of production factors;
- taking into account production control measures; and
- using a fixed external reference price, with which to compare domestic farm-gate prices.

The purpose of fixing an external price, instead of using a variable representative world market price, is to focus the SMU reduction in terms of domestic support levels.

The EC specifies that the SMU would cover:

- measures to support market prices;
- direct payments linked to production or to factors of production;
- measures aimed at reducing input costs which are commodity-specific, or which can be feasibly calculated by commodity; and
- all measures affecting support levels, whether applied internally or at the border.

The commitments to reduce support would be expressed as a percentage reduction of SMU, calculated both on a unit and total basis. They could vary by product group. Commitments would be adjusted according to developments in world market prices. This could mean a possible halt to support reduction, in the event of high prices on the world market. The EC also foresees a provision to ensure that adjustments are comparable among different countries, despite differences in inflation rate.

Reductions would be measured against the reference year of 1986. They would take place over five years in a first stage. The absolute amount of reduction of the SMU would be in principle the same each year of the agreed period, before being adjusted upwards or downwards in order to take into account trends in world markets. The market situation would be studied during the fourth year, to determine the subsequent extent and rate of reduction in support.

Under the EC proposal, individual country schedules in terms of SMU reductions would be bound. Contracting parties would not necessarily need to identify national policy instruments they intended to adjust to comply with the binding of their support levels - they would be binding an overall number or percentage. But the EC does allow that they could be requested to do so. The Community itself has stated "its readiness to indicate, if necessary, what kind of changes in policy instruments, including border protection", it would apply to reduce the SMU as agreed.

The reduction of support in terms of the SMU would apply only to the main agricultural commodity sectors. For the EC, these include: cereals, rice, sugar, oilseeds and oleaginous fruit, dairy products, beef and veal, pigmeat, eggs and poultrymeat. Processed products incorporating these would be covered by reduction commitments, through the use of transformation or incorporation coefficients. "Equivalent commitments" should be undertaken for other products.

3. Other proposals

Other proposals seek to exempt from reduction commitments certain policies undertaken for specific objectives. Austria, Japan, Republic of Korea, the Nordic countries and Switzerland believe that reduction commitments should not cover domestic subsidies accorded in the pursuit of non-trade objectives such as the protection of the environment, land use, rural employment and food security. Switzerland proposes that domestic subsidies granted by countries agreeing to guarantee minimum market access should be permitted, provided that the products thus subsidized are not exported and the market access undertakings are duly fulfilled. Japan, moreover, would exclude from

AMS reduction those products with a high import ratio to consumption.[3]

Developing countries believe that the domestic subsidies they apply, which are necessary for development purposes, should be excluded from reduction commitments. Colombia and Thailand have proposed that developing countries should not be barred from maintaining support policies, which are designed to replace illicit narcotic crops with other cash crops.[4]

4. Implications for developing countries

Important differences exist between the two major options described above, in terms of policy flexibility, product coverage, base year and ultimate goals. The United States (and Cairns Group) proposal delineates the agricultural support policies to be disciplined and defines the commitments in policy terms. All commodities which are eligible for farm support would therefore be covered. The level against which support reductions would be measured is that prevailing during 1986-1988. The stated goal of the United States proposal is the elimination of certain specific support policies considered *a priori* as trade-distorting, such as fixed price support, in favour of policies de-coupled from production or trade effects.

The EC proposal, on the other hand, would reduce support levels in terms of overall costs, but governments would retain the right to use whatever policy instruments they choose. As the reduction commitment would be made in terms of an SMU, only the major-traded commodities for which an SMU can be calculated would be covered. Other products would be subject to equivalent commitments, as yet undefined. There would be more scope to shift support among product groups within overall target reductions. The base year for measuring support reductions would be 1986 (a higher base year of support for the EC than 1987 and 1988). The EC proposal does not specify the ultimate level down to which support will be reduced, but it is doubtful that zero support would be envisaged. The provision for a re-assessment of reduction commitments after four years implies a short-term objective for policy reform. Thus, the United States and Cairns Group proposals would imply at face value more substantial reductions among the developed countries in specific trade-distorting support policies on more agricultural products than the EC proposal.

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[3] See below, section I.D.

[4] See below, section I.G.

The implications of the two above options with respect to developing countries depends on the extent that special and differential treatment will be granted. Proposals for special and differential treatment on internal support will be described more fully under section I.G. Under the above options being considered, a number of categories of policies would be exempt from reduction commitments anyway, for all participants. The real question is whether and to what extent developing countries can maintain, or will have to reduce, if not eliminate, their support policies which are directly tied to production or prices - such as specifically administered price policies, income support linked to production, and subsidies on inputs or investment which are commodity-specific.

Many developing countries maintain support prices for major food grain, oilseed, and fiber crops. Large shares of public investment have been allocated to develop farm infrastructure and subsidize inputs, such as irrigation, fertilizer, and credit. Yet the effects of these input subsidies do not generally offset the taxes on producers imposed through export taxes and State-trading procurement policies, which favour consumers. The case can be made *inter alia* that as it appears that most of these countries tax their agricultural sector on balance, it would not be appropriate to reduce what little support is available. Moreover, there is a compelling need for these countries to increase productivity, and therefore producer support.

The Republic of Korea appears to be an exception in the Asia-Pacific region, by maintaining policies which seem overall to favour or subsidize farmers. However, this follows a long period of disincentives to agriculture during the industrialization process. The agricultural sector is relatively underdeveloped in comparison to industry. Subsidization over a suitable transitional period is required to achieve productivity potential and establish parity between farm and non-farm incomes - what developed countries have been allowed to do under the GATT for four decades.

B. Import access

The fundamental question in relation to import access is what should be the acceptable form and degree of border protection for agriculture. Should tariffs be the primary means of protection against imports? Should there be a fixed general level of tariffs? To what extent should tariffs be bound? What will be the future scope for governments to apply non-tariff barriers?

Permission to apply quantitative restrictions on agricultural products exists under several provisions of the General Agreement (for example, articles XI:2, XIX) at present, and also under separate instruments accorded to individual contracting parties (United States waiver, Swiss Protocol of Accession). The criteria under the General Agreement provisions are often not satisfied, or are subject to differing interpretations. Certain barriers such as variable levies virtually escape any kind of GATT discipline.

The options being proposed in relation to border protection in general range from a proposal that only bound tariffs fixed at zero or low rates be used, to the view that no specific commitments are needed other than disciplines on internal support (and a "re-balancing" of protective levels among competing commodities). The options being proposed in relation to non-tariff barriers range from their elimination through conversion into tariffs, to various proposals delineating the conditions under which non-tariff barriers can be resorted to. The options being proposed in relation to tariffs concern the formula to be used for their reduction (formula with harmonizing element, request/offer procedure), their final agreed level, and the extent of bindings.

1. Non-tariff barriers

(i) Tariffication

The United States has proposed the conversion of all non-tariff barriers into bound tariffs, a process known as "tariffication". No new non-tariff measures would be permitted. Existing non-tariff barriers would be converted into *ad valorem* or unit-based equivalents. The United States proposed the following formula for calculating *ad valorem* tariff equivalents:

$$TE = \{(Pd-Pw) / Pw\} \times 100$$

where TE is Tariff Equivalent, Pd is Domestic Price, and Pw is World Price.

The level of protection represented by a non-tariff measure would be based on the ratio of the average annual price gap (between domestic and world prices) over the world price during 1986-1988.

As a transitional measure, the United States proposes that non-tariff barriers would be replaced with tariff quotas on 1 January 1991. The initial tariff quotas would be set for each tariff-line at a level equivalent to: (a) the level of imports existing in 1990 or 1986-88, whichever is higher; or (b) a negotiated minimum level in case of no previous imports (e.g. one per cent of domestic consumption); and (c) a tariff rate at the final bound level to be agreed upon. The liberalization of import access would be achieved through progressive annual reduction of the over-quota tariffs to final bound rates, and through the expansion of the initial quotas by agreed minimum amounts. Country-specific allocations would be maintained in the initial tariff quota, but subsequent expansions of the quota during the transitional period would be made on a global basis.

Within each year during the transition period, a requesting country would be allowed to revert back to a specified level of tariff protection on an MFN basis for the remainder of the year ("snapback"), whenever imports in that year exceeded a certain percentage above the previous year's imports. The trigger level would be equal to 160 per cent of the previous year's imports, where imports accounted for less than 3 per cent of domestic consumption; or 120 per cent where they were 3 per cent or more. The two trigger levels are meant to ensure more rapid growth in import volumes by countries with relatively low imports due to trade barriers. A different safeguard mechanism might be necessary for perishable products to allow for a tariff snapback on a more timely basis. After the transition period, all safeguard actions would be governed by the revised article XIX. At the end of the transition period of ten years, the final tariffs (including those resulting from tariffication and those within each tariff quota) would be bound at zero or low levels.

With the exception of Canada, which wishes to retain quotas for supply management purposes,[5] the Cairns Group supports tariffication. The Group places emphasis on reducing barriers on a global basis and in a harmonizing manner, i.e. deeper cuts for those barriers with higher protective incidence. Accordingly, the Group suggests setting agreed ceilings on the initial tariff equivalents. It wants a reduction formula applied which has a harmonizing effect. Moreover, provision should be made for supplementary reductions under request/offer negotiations.

A few other participants have expressed support for some measure of conversion of quantitative restrictions, but on a more limited basis than that proposed by the United States.[6] The Nordic countries, for example, would consider tariffication, provided that initial tariff equivalents are set high, a safeguard mechanism is built into the conversion formula, and the reduction process is based on negotiation and reciprocity. But they would wish to retain recourse to variable levies under the General Agreement.

The European Community basically considers that commitments undertaken on the basis of the SMU, necessarily affect the level of border protection, negating the need for separate commitments on the latter. However, the EC would be willing to make specific commitments toward tariffication, provided that: (a) imbalances in border protection were corrected; (b) deficiency payments were converted into tariffs; and (c) tariffs consisted of a fixed component and a corrective factor, to adjust for variations in exchange rates and world markets. With respect to (a), this presumably would signify that the EC could engage in the "re-balancing" of its higher levels of protection for cereals vis-à-vis cereal substitutes and oilseeds.

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[5] See next section I.B.1(ii), below.

[6] See also Section I.D.

The EC rationale for converting deficiency payments is that, by allowing production to take place despite low internal market prices, they act like import quotas when a country's self-sufficiency is less than 100 per cent, and like import prohibitions when the rate is higher. The EC proposes that tariffication would apply to all products covered by an SMU or PSE calculation, and other products subject to deficiency payments. Tariffication should also apply to the derivatives (in processed form at first and second stages), and substitutes of basic products.

The level of the "fixed component" would be negotiated, based on the combined effects of an entry price, internal price, and a fixed external reference price. This component, expressed as an absolute value, would be subject to reduction over the five-year reference period, and subject to GATT bindings. For the EC, the rate of reduction is negotiable, but should be related to the SMU reduction on internal support. A "corrective factor" should be added or subtracted from the fixed component in order to compensate for exchange rate variations to the full extent, and for world market fluctuations beyond negotiated limits ("franchise element").

(ii) New rules and disciplines on non-tariff barriers

Proposals to negotiate a new safeguard regime in the Uruguay Round, possibly entailing a revised article XIX applicable to both industrial and agricultural goods alike, are under consideration. The question before the Negotiating Group on Agriculture is whether there should be safeguard-type provisions specific to agriculture. There are options which seek to allow quantitative restrictions in order to protect domestic supply management regimes under more "operational" terms than those of XI:2(c), or agricultural policies pursued for non-trade objectives, such as food security.[7] Conceivably the safeguard mechanism being proposed above for use during a transition period (tariff snapback) could be retained in modified form on a permanent basis.

Those who would retain the possibility of recourse to import quotas for protecting domestic supply management have proposed options to make the criteria and article XI:2(c) more operational or predictable. These basically concern the effectiveness of governmental supply restrictions, the product coverage of the import restrictions, and the level of the quotas or minimum access.

With respect to defining better what constitutes governmental measures to restrict effectively domestic production and marketing, Canada has proposed that controls should be deemed effective only if:

- production or marketing does not exceed a designated level which should be notified at the beginning of each production or marketing control period;
- penalty provisions exist at the individual farm level for over-quota production or marketing which ensure that the designated level is not exceeded; and
- virtually all domestic production is under effective supply control.

For Japan, "governmental measures" should be deemed as including effective measures taken by a government, even when they are not necessarily based on legislation. "Production restriction" should mean an effective restriction of production, such as the restriction of cultivated area, or the operation of a price support system which has the effect of restricting the quantity of domestic production.

Canada, Japan and the Republic of Korea propose providing clear permission for restricting imports of processed products which, if freely imported, would nullify the effectiveness of production restrictions on fresh products. Canada would limit the scope of import restrictions to those processed products which are made "wholly or mainly" from the fresh product under domestic supply control. "Wholly or mainly" would be defined by an agreed list of designated products and by a negotiated minimum percentage by dry weight of the fresh product.

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[7] The latter will be discussed under section I.D., below.

Currently under article XI:2(c), the level of import quotas is to be determined on the basis of the proportion of imports to domestic production over a previous representative period. This is difficult to establish, especially where imports have been restricted over a long period to a negligible level. One option proposed is to set a minimum access level to govern future quotas. The latter would be fixed as a pre-established minimum percentage of domestic production, either under an agreed formula applicable in general, or negotiated individually to form part of the importing country's GATT schedule.

The options to maintain import quotas for domestic supply control or to protect non-commercial agricultural policies,[8] all coincide with the need for disciplines on the exportation of the agricultural products concerned. In other words, import protection should not enable a country to become a net exporter or disrupt trade in third markets.

With respect to variable levies and minimum import prices, the EC proposes that they be covered under an improved article XI. It suggests that support commitments be considered as equivalent to production control "if it can be demonstrated that these measures contribute to the restriction of production". This would introduce the SMU into the disciplines of article XI:2(c). Moreover, the Community is willing to negotiate the method of calculation of the entry price, which is a function of the variable levy, and the binding of minimum import prices.

Many proposals call for ensuring that State-trading enterprises are brought under the more effective General Agreement disciplines being worked out on agricultural protection. The EC proposes that there should be a minimum access established, if the activities of State-trading enterprises or boards lead to a *de facto* import prohibition. There have been proposals in another Negotiating Group that would make more rigorous the disciplines on State-trading enterprises under article XVII, particularly to cover all the operating methods of marketing boards and invitations to tender.

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[8] Described in section I.D.

Developing countries should retain the possibility of resorting to restrictions under the provisions of article XVIII. It has been proposed that they be specifically authorized under article XI to apply restrictions to ensure supplies of basic wage goods indigenously.[9]

2. Tariffs

The United States proposes that all agricultural tariffs be reduced to bound zero or low levels within a ten-year transition period. The Cairns Group proposes that existing tariffs be reduced on a formula basis, which would achieve lower and more uniform rates. There could also be, through a request/offer process, specific negotiated reductions going beyond the formula approach, resulting in total tariff elimination in particular cases. The new rates would be bound within each participant's GATT tariff schedule.

The basic EC approach is for a progressive reduction of border protection in conjunction with support, to the extent necessary to re-establish balanced markets and a more market-oriented trading system. For products subject to a tariff, the EC proposes a request/offer procedure.

Many proposals call for developing countries to be accorded greater flexibility in making cuts in their import access barriers. It has been suggested that their concessions be linked to tangible benefits they derive from concessions granted by developed countries. Developed countries are asked to make accelerated reductions in their barriers, with respect to products of export interest to developing countries.[10]

3. Implications for developing countries

It is difficult to assess the implications of the above options in terms of access for developing countries. Not only must the effective degree of protection which might result be considered, but also the qualitative differences among the forms of trade barriers be taken into account. Market access opportunities will be affected by new disciplines regarding internal support and by their consequences on supplies. Much will also depend on the scope for safeguard restrictions on agricultural imports under new rules as yet undefined. Moreover, the options described above are not necessarily to be treated as alternatives. The ultimate package will likely combine elements of them all, some implying trade liberalization, others perhaps less. Finally, the individual interests of developing countries may not always coincide on all product or access issues.

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[9] See section I.G.

[10] See section I.G.

The underlying premise of the United States and the Cairns Group is that certain forms of support are intrinsically more trade-distorting than others. In the case of border protection, it is non-tariff barriers including variable levies, which these countries suggest should be substantially reduced through tariffication, if not eliminated. They also propose that all tariffs be bound and reduced to low levels.

One of the principal tenets of the General Agreement is that tariffs should be the primary means of border protection, because they are transparent and their levels can be bound and negotiated down. However, if a liberal quota is converted to a high tariff there may in fact be less access, at least in the short term until the tariff is reduced to a low or zero level. This is why the Cairns Group has proposed a ceiling on the tariff equivalent.

The reduction and binding of a tariff enhances the legal value of the concession, because it constitutes insurance against nullification or impairment of anticipated benefits and bestows a right for compensation. It is an important factor to consider in the equation when comparing, for example, the value of a bound high tariff with an unbound lower tariff or a more liberal quota.

The European Community is less policy-specific in its approach on border protection than the United States and the Cairns Group. It considers that the progressive reduction of support through commitments undertaken on the basis of SMUs will necessarily effect the level of border protection, which is a component of the SMU. The EC proposes to follow a request/offer procedure for products subject to tariffs only, which may be less favourable to developing countries than a formula approach.

As regards variable levies, the European Community will not forego this important instrument of its Common Agricultural Policy. It is willing to accept more discipline in how they are calculated through fixing a ceilling on some of its components. This might reduce any overcompensation for price gaps under current methods, but would not change the primary function of levies, which is to nullify price competition between imports and EC products.

The Cairns Group also emphasizes uneven levels of protection and access as trade-distorting. It has proposed that import barriers be reduced in a harmonizing manner to assure that general levels of protection are the same and low.

With regard to protection among agricultural sectors, it should be noted that tariff escalation constitutes an important impediment against developing countries' exports of processed agricultural products. It often stymies their opportunities to develop from being suppliers of raw materials. A goal in the negotiations on tropical products has been to reduce this problem.

The EC proposal for "re-balancing" protection among sectors would appear to run counter to a general drive for lower protection. It is the stated intention of the EC to increase the protection it applies on oilseeds and other commodities, which compete with EC grains.

A fundamental consideration in evaluating the benefits of global liberalization under the United States and Cairns Group proposals is the consequences on preferential margins or market shares. The advantages that a developing country derives or may potentially derive from a preferential duty will be less if the preferential margin is reduced. This obvious fact must however be weighed against two other facts.

The first is that generalized or other preferences accorded by developed countries have been circumscribed, and the benefits to be derived therefrom have been less than those expected by developing countries. Many agricultural products are excluded under the Generalized System of Preferences (GSP), particularly products which compete with those produced by developed countries. For example, the United States excludes sugar, dairy products, peanuts, and cotton. Where preferences are given to an agricultural product under the GSP or other schemes, there are often minimum import prices or quota limitations applicable. Preferential quota shares tend to be static in relative and absolute terms, and penalize the more competitive suppliers.

Therefore global liberalization may not have serious adverse effects for developing countries in general with respect to preferential margins, and may offer them improved benefits in alternative markets. This being said, however, there are instances where preferential margins or shares are significant, e.g. EC preferences to African-Caribbean-Pacific countries or to the least-developed developing countries on certain products. Loss of preferential margins in such cases could pose serious difficulties for the export earnings of the affected countries in the short and medium term. It has been suggested that compensation be granted to developing countries for reductions in export earnings arising from the loss of preferential market access.[11]

The second fact to be considered is that the industrialized countries have not bound the preferences they give to developing countries under the General Agreement. The withdrawal or modification of benefits deriving from GSP and other preferences would not imply nullification or impairment of concessions or give rise to compensation to the preference-receiving countries under the GATT. Clearly an improved contractual basis for access into the markets of developed countries is needed for the developing countries. The chances for doing so on a most-favoured-nation basis would appear to be better than on a preferential one. A bound tariff, albeit at a level above that of an unbound preferential tariff, may constitute a significant advantage.

Just as important to take into account will be the new rules and disciplines on safeguard action against agricultural imports to be universally applied. How they are drafted will determine whether the gains from tariff reductions or the conversion of non-tariff barriers will be sustained or nullified.

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[11] See section I.G.

Virtually all proposals agree in calling for the elimination of agricultural exemptions specific to individual countries, such as the waiver for United States quotas applied under Section 22 of the Agricultural Adjustment Act (currently applied on dairy products, cotton, peanuts, and sugar), and the provision for import quotas under Switzerland's Protocol of Accession.

As regards rules of general application, the United States has stated that all safeguard actions should be based on article XIX, as may be revised. The United States is trying to include thereunder specific authorization for acting against imports of perishable products on a timely basis. The proceedings of the Negotiating Group on Safeguards would need to be monitored to ensure that any new General Agreement safeguard clause does not become a means of permanent protection.

Canada has proposed that recourse to quotas still be available for purposes of domestic supply management under a revised article XI:2(c). Japan, Republic of Korea, and Switzerland want specific provision to restrict imports for purposes of food security or to maintain a minimum agriculture.[12]

Some proposals would define what constitutes effective government restrictions on domestic supplies, in a manner which would constrict eligibility to justify import quotas. Other suggestions, however, seek to expand the possibility to restrict imports of processed products. This might provide legal cover to quotas which would be judged illegal under present standards of GATT case law.

Proposals to fix a minimum market access level to govern future quotas might be advantageous. It would eliminate the existing uncertainty in applying the current standard of respecting a proportion of imports to domestic production during a representative period.

Recourse to article XVIII should continue to be available to developing countries. The possibility to resort to quantitative restrictions for domestic supply management, if retained under article XI, would perhaps be of little practical benefit for developing countries, because they do not normally engage in production control. A specific provision allowing developing countries to take quantitative restrictions other than for balance-of-payments reasons may be necessary under article XI.[13] Each developing country must determine the advantages and disadvantage of using tariffs or quotas to carry out their policy objectives. The former are revenue-enhancing for the importing government. The latter usually grant quota rents to exporting countries and require a more complex internal machinery to administer.

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[12] See section I.D.

As many developing countries maintain State monopolies or marketing boards on agricultural commodities, it is important to monitor the proceedings of the Negotiating Group on GATT Articles with respect to proposed new disciplines on State-trading enterprises under article XVII.

In conclusion, it is obvious that the United States and Cairns Group proposals would offer more pronounced liberalization on a global basis, through the substantial reduction and binding of tariffs and the elimination of non-tariff barriers. New rules governing safeguard action on agricultural imports would be equally important to consider as the concessions themselves. Some options may facilitate restrictions on perishable products and processed products, for example, or otherwise permit restrictions which would be judged illegal under current GATT case law.

Overall implications can only be speculative without better knowledge of the real commitments developed countries are willing to undertake on products of export interest to developing countries. Of particular importance, for instance to the Asia-Pacific countries, will be the new terms of access for sugar, rice, wheat, corn, cassava, oilseeds, and cotton in developed-country markets. Currently their exports are subject to quantitative restrictions of one sort or another.

Reciprocal commitments by developing countries must be conditional on tangible benefits they receive in terms of new market opportunities and suitable compensation for losses of preferential margins or shares, if any. A formal rule tying individual concessions directly on a bilateral basis, as suggested, should perhaps be eschewed as implicitly sanctioning bilateralism, which is ultimately not in the interest of developing countries. Due credit should be given to developing countries for having already undertaken measures to open their markets. Several developing countries - e.g. Republic of Korea - have liberalized their agricultural import quota regime.

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[13] See sections I.D. and I.G.

All developing countries should stand to gain from an improved contractual status for their market access, and rules which are universally applied. The final scoring of pluses and minuses, advantages and losses, however, can only be made on an individual country basis.

C. Export competition

The fundamental question before the Negotiating Group, with respect to export competition, is how to reduce export subsidization. The two major options being considered are:

- A ban on all direct export subsidies, with the exception of food aid (on a grant basis); and
- A limitation of the amount of export subsidy to the difference between internal and world prices, improved interpretation of existing General Agreement rules, and the extension of the present OECD consensus on export credits to agricultural products.

1. Export subsidy ban

The United States proposes that contracting parties do not grant any form of subsidy on exports of agricultural products. The phase-out would be implemented within five years, based on either government expenditures and revenue losses, or quantities of commodities, and using 1986-1988 as a base period. The list of prohibited export subsidies would be that of the Illustrative List of Export Subsidies contained in the Subsidies Code. The list could be revised if necessary, to ensure the inclusion of all export subsidies specific to the agricultural trading system.

Only *bona fide* food aid would be exempt from the prohibition on export subsidies under the United States plan. There would be new agreed guidelines clarifying the conditions under which food aid may be provided: the categories of eligible countries, the kinds of commodities which could be provided, and what concessional arrangement would be permissible.

The United States proposes that disciplines on export credits for agriculture be subject to the same disciplines as those imposed on non-agricultural products by the Subsidies Code, as revised in the Uruguay Round. The current Illustrative List permits export credit guarantees as long as the programme operates to cover its long-term operating costs and losses. In addition, it states that governments may not grant export credits at rates below their current market rates. The United States seeks to have it required under the Code that the duration of guarantees conform to commercial practice, and that credits be at terms and conditions otherwise available to the borrower (not government borrowing rates).

The Cairns Group also proposes a phase-out and prohibition of existing export subsidies, but over a transition period of ten years. Commitments to reduce would be made on both a per-unit and total-outlay basis. The Cairns Group also believes that all food aid should be provided on a grant basis. Participants should also channel food aid through international organizations to the extent possible.

2. Export subsidy limitation

The European Community proposes that the level of export subsidies should not exceed the difference between the world market price (using the f.o.b. price on a representative market) and the exporting country's domestic price, for products where this calculation is feasible (in general, those covered by an SMU). The EC further suggests that the export-subsidy amount not exceed the amount of the charge levied on imports for the same product. These calculations are made on a per-unit basis.

The EC believes that no commitment is necessary at the budgetary level on how much is spent on export subsidies, because the combined effect of reduced internal support and higher world market prices will result in countries having to spend less on exports. Export subsidies could be differentiated by country destinations.

The EC's suggested improvements to existing General Agreement rules on export subsidies are as follows. The "previous representative period" under article XVI:3 would be defined as the average of three of the five most recent calendar years for each contracting party. There would be no more reference in the provision to taking into account "any special factors" affecting trade. When the level of subsidized exports exceeded this reference level, the burden of proof would fall on the exporting party to demonstrate that its acquired share was not more than its equitable share. Moreover, as regards subsidizing the primary product component of a processed product, the EC proposes that the subsidization be limited to the difference between the domestic price and the world market price of the commodity. The EC proposes that the OECD arrangement on guidelines for officially supported export credits should be extended to cover agricultural products, and be made applicable in the General Agreement framework so that all exporters of agricultural products will be bound by it.

It has been suggested that developing countries undertake commitments with respect to export subsidies consistent with their development, financial, and trade needs. It has also been proposed that compensation or offsetting measures be granted to the net food-importing developing countries for increased food costs as a result of subsidy reform.[14]

3. Implications for developing countries

The United States and Cairns Group proposals are policy-specific, seeking to eliminate direct export subsidies. The kinds of export subsidies to be proscribed would be described in a list. There would basically be two categories of transactions on the world market at the end of the transition period: legitimate food aid and sales on fully commercial terms.

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[14] See section I.G, below.

The EC proposal seeks to preserve the distinction between export subsidies on primary and processed agricultural products, and maintain the dual-price system. It provides a more direct linkage between the fixing of variable-import levy and export-subsidy levels. The Community attempts to minimize overcompensation in per-unit subsidy amounts. But price undercutting in any individual market is not necessarily precluded. There would be no limits *per se* on overall export-subsidy outlays. The equitable share obligation, which has proven to be an unworkable discipline on the trade effects of subsidies, would be retained, using a more predictable and static definition of the term.

The EC argues that its gradual reduction in domestic support levels should inevitably lead to improved opportunities for its competitors both in the EC and other markets. But all in all, it would seem that the general level of exports available from the Community would likely be maintained, as would its world export share, although at somewhat diminished costs.

Exporting developed countries want to limit competition among themselves in official credits. The United States seeks to define more strictly the recipient countries eligible for food aid. Thus subsidy reform may in particular curtail concessional sales to the middle-income developing countries. Like tariff preferences, food aid has operated as a unilateral gift. It has often reflected the objectives of the donor countries who wanted to get rid of unwanted domestic surpluses, rather than responded to the dietary needs of the recipients. It would be useful to improve the contractual basis under which food aid is accorded, and secure a level that adequately corresponds to the short and long-term needs of the developing countries.[15]

D. Non-trade concerns

The issue of non-trade concerns is included as a separate section of this paper *inter alia* because it receives specific mention in the Negotiating Group's work programme. However, it could just as easily have been treated under internal support and import access, to which the options for taking these concerns into account refer. Non-trade concerns relate to certain socio-political objectives pursued under agricultural policies - e.g. stemming migration from rural areas, preserving the traditional unit of farming, preventing environmental damage to the countryside, and assuring secure and stable food supplies. These concerns exist in varying degrees for all countries.

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[15] See section I.G.

There are basically two options with respect to taking non-trade concerns into account in the reform package. The first is to provide specific exceptions for domestic subsidies and import restrictions deemed necessary for carrying out these objectives. The second is to require that these concerns be met through measures which do not distort production and trade.

Austria, the Nordic countries, Japan, Republic of Korea, and Switzerland have in particular emphasized non-trade concerns in the negotiations. They are all net agricultural importing countries. For Japan, food security means maintaining domestic production of basic foodstuffs, which have traditionally been the main source of nutrition for its citizens. Switzerland speaks of a nations's fundamental right to an agriculture in keeping with national particularities. The Republic of Korea aims to enable its agricultural sector to achieve balanced development vis-à-vis its industrial sector. It also wishes to maintain a minimum level of production or self-sufficiency for food security and national security purposes.

With respect to internal support, Japan proposes that the AMS be the vehicle for reduction commitments, rather than for policy-specific commitments. The AMS should exclude structural aid, production and surplus control expenditure, social welfare, research and development, and environment-oriented subsidies. Japan, moreover, would exclude from AMS reduction those products with a high import ratio to consumption. The Republic of Korea would also exclude subsidies which assist the non-economic functions of agriculture, including *inter alia*, food reserve programmes.

Switzerland proposes that domestic subsidies granted by countries agreeing to guarantee minimum market access should be permitted. These countries would also agree to transform part of price support into direct payments. With respect to import access, options offered by

Japan, Republic of Korea, and Switzerland would permit import quotas to assure that a certain level of domestic production is maintained, or that a certain level of the market is supplied domestically.

Japan proposes that contracting parties be permitted to take border adjustment measures to maintain domestic production levels in basic foodstuffs. It defines these as agricultural products which are indispensable for the maintenance of a nation's livelihood of citizens:

- Which have traditionally been the main source of nutrition for the citizens, and constituted an important part of their daily caloric intake; and
- Which will be produced and supplied on a stable basis in normal circumstances, and on a priority basis at times of food shortage.

Switzerland proposes that countries operating minimum agriculture would undertake minimum market access commitments. The overall minimum market access would be negotiated on the basis of a percentage ratio between agricultural imports and domestic consumption. Excess production would have to be donated to an international agency, which would sell the products at market prices. The proceeds would go towards developing agricultural infrastructure in developing countries, particularly net food-importing ones. Switzerland could foresee some conversion of quantitative restrictions into levies. These would be fixed on the basis of an average reference price expressed in local currency, and adjusted for exchange rate and world price fluctuations. Levy reductions should be weighted by a country's self-sufficiency rate.

The Cairns Group counters that food security and other non-trade concerns should be met through policies de-coupled from production and trade. They believe that food security should be realized chiefly through more secure and diversified import sources, stockpiling, and the improved market orientation resulting from the reformed agricultural trading system. The United States also suggests that food security can be assured by disallowing export prohibitions and restrictions on food to relieve critical shortages under article XI:2(a).[16]

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[16] See section I.E.

1. Implications for developing countries

There is a danger that excessive emphasis on food security and other non-trade concerns may be used by developed countries to justify limiting further access opportunities for developing countries in these markets. There are significant differences between developed and developing countries with respect to food security. The former need never go hungry because, barring a world calamity, they will always be able to find and pay for their food in the world market, and distribute it on a timely basis. Moreover, it is a common phenomenon that as living standards in a country improve, the demand for a larger variety of food grows, not all of which can be supplied efficiently from domestic sources. Industrialized countries have more financial resources for developing support de-coupled from production or trade effects, and fewer farmers as a portion of their population to take care of, than developing countries.

E. Export restrictions

The United States proposes that contracting parties no longer be permitted under article XI:2(a), to prohibit or restrict exports of foodstuffs, in order to prevent or relieve critical shortages thereof. Presumably permission to prohibit or restrict exports of essential products other than foodstuffs, would be retained under this provision.

Japan believes that there is a need for a clearer definition of the term "critical shortage" as used under article XI:2(a). The Republic of Korea proposes that export prohibitions and restrictions should only be permitted to meet certain minimum levels of self-sufficiency of exporting countries. Switzerland suggests that the provision be revised to take better account of the needs of importing countries. The Nordic countries have stated that the use of food as a means of political pressure should be effectively proscribed. The Cairns Group has noted that contracting parties should be able to prohibit or restrict exports in order to carry out their commitments under international commodity agreements (article XX(h)), e.g. the International Coffee Agreement. It has been proposed that developing countries maintain the right to prohibit or restrict their exports of food.[17]

The United States also proposes the progressive reduction and elimination within five years of differential export tax structures, which discourage exports of raw materials in order to ensure a ready supply of inputs for domestic processing industries.

1. Implications for developing countries

The United States proposal to modify article XI:2(a) is a response to the expressed concerns on food security of such countries as Japan, described in the previous section. Proposals to revise article XI:2(a) alone - to give an appearance of reciprocal obligations by exporting countries to provide secure and stable supplies to importing countries, in exchange for their access commitments - ignore two facts. The first is that in periods of critical shortage, distribution will be realized on the basis of purchasing power. Secondly, in many instances, food exports have been restricted by governments of industrialized countries for political reasons, rather than for considerations of adequate domestic supplies. Accordingly, a commitment not to use food as a political weapon would perhaps be more valuable than doing away with the possibility of restricting exports in periods of critical shortage.

Even more pertinent is the call by the net food-importing developing countries for increased multilateral funding for them to pay for their food imports in the short term, when commitments to reduce government subsidies by industrialized countries may lead to price rises. They have also asked for positive measures to assure their development and enhanced agricultural productivity in the long term.[18]

Article XI:2 (a) should be retained for developing countries, since they have less purchasing power to assure adequate food supplies than developed countries. Developing countries should also retain the possibility to apply export taxes, where there are no alternative revenue-raising sources. Moreover, export restrictions or taxes applied by developing countries on domestic materials needed by their local processing industries are the mirror image of industrialized-country protection for their industries. The latter, however, take different forms: subsidies on domestic materials used by industries, high tariffs on imports of processed products, and anti-dumping and countervailing duties.

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[17] See section I.G.

[18] See section I.G.

F. Sanitary and phytosanitary measures

The fundamental question before the Negotiating Group is how to assure that health, sanitary and phytosanitary measures are based on sound and verifiable scientific evidence, and that they do not operate as unnecessary and disguised barriers to trade. To this end, the proposals seek to encourage under the General Agreement the harmonization of national measures, through the adoption of international standards established by appropriate international standardizing bodies. The proposals also seek to improve GATT notification, consultation and dispute settlement procedures in this area.

There appears to be a consensus that a national measure which conforms to an international standard should be deemed as necessary to protect human, animal or plant life or health, and as consistent with article XX(b). However, proposed options differ as to: which standardizing bodies should be recognized for this purpose; the extent to which national standards may differ or be more stringent than international standards; the scope for applying principles of national treatment, i.e. different methods for equivalent results; the methods for assessing an acceptable level of risk; and the recognition of pest or disease-free areas.

Another unresolved issue is whether any newly agreed disciplines on sanitary and phytosanitary measures should be assimilated under an appropriately revised Code on Technical Barriers to Trade (Standards Code) or form a separate agreement.

The United States proposes that article XX(b) be amended to ensure that sanitary and phytosanitary measures "are consistent with sound scientific evidence and recognize the principle of equivalency." A measure would be deemed to conform to this standard, if it is equivalent to an appropriate standard established by the Codex Alimentarius Commission, the International Office of Epizootics, the International Plant Protection Convention, or other scientific organizations open to full participation by all contracting parties. A contracting party which did not use an international standard would have the burden of proving that its measures were based on sound scientific evidence.

The European Community recognizes the three abovementioned organizations as a principal source of scientific or technical advice in considering sanitary and phytosanitary aspects of international trade. But the EC wants it recognized that advice will also be considered, where appropriate, from the World Health Organization, and from those organizations engaged in harmonization on a regional basis, such as the United Nations Economic Commission for Europe, the OECD, and the European and Mediterranean Plant Protection Organization. The Cairns Group and the Nordic countries also would recognize and encourage harmonization on a regional basis. The Negotiating Group has requested the International Office of Epizootics to develop guidelines for the use of trade restrictions with regard to foot-and-mouth disease.

There are proposals for improving procedures under the General Agreement for notification (on existing and planned regulations prior to implementation, establishing "inquiry points"), counter-notification, and consultation. There is a general re-affirmation that panels have the right to call upon scientific experts. For this purpose, it is proposed that a roster be maintained of experts, nominated by recognized international organizations, who would be available to provide technical expertise to panels.

The Cairns Group proposes a freeze on introducing new sanitary or phytosanitary measures or intensifying existing ones. It also calls for compensation to developing countries for measures applied to them which are not supported by scientific evidence. Many proposals suggest that there should be longer time-frames for developing countries to comply with standards where risks allow, and that technical assistance be accorded to them.[19]

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[19] See section I.G.

The Nordic countries have proposed a detailed code establishing disciplines on sanitary and phytosanitary measures and procedures. The code would cover the following: regulations concerning agricultural products; processes and production methods; testing, inspection, certification and approval procedures; quarantine treatment; packaging and labelling requirements; and relevant statistical methods, sampling procedures and risk assessment.

The Standards Code has been considered ineffective as regards sanitary and phytosanitary measures, because it essentially does not cover production and processing methods, on the basis of which many technical regulations and standards are established in the agricultural sector. The EC is proposing that an appropriate framework of rules be drafted on agri-food process and production methods, to be supplemented by *ad hoc* negotiations.

1. Implications for developing countries

There appears to be a consensus that sanitary and phytosanitary measures should be governed by the principles of scientific evidence and equivalency. It remains to be seen how they will apply to individual cases.

Most of the new disciplines proposed on sanitary and phytosanitary measures are of a procedural order. They put a premium on harmonized international standards. But harmonization of standards is a slow-moving process. International standards, where they exist, tend to be set at a low common denominator. Governments are free to apply more restrictive conditions. Moreover, allowing developing countries a longer time-frame to comply with international standards, where these exist, might delay access for their products.

The disciplines proposed would at least increase the burden on importing countries to demonstrate the scientific justification for their restrictions. With increased input of technical expertise, contracting parties would be better equipped to judge whether restrictions went beyond what was scientifically necessary to fulfil the purposes of article XX(b).

Two points of contention are which international standards organizations should be recognized, and whether the agreed disciplines on agricultural sanitary and phytosanitary measures will form a separate declaration, or be incorporated into an appropriately revised Code on Technical Barriers to Trade (Standards Code). Motivating the United States proposal that only organizations open to multilateral participation be recognized, is its concern that after 1992, the EC will have developed its own common regional standards, which will shut out United States exports.

G. Special and differential treatment for developing countries

There are proposals for according special and differential treatment to developing countries, under virtually each element of the agricultural reform package. They cover: (1) exemptions the developing countries should have from the commitments to reduce agricultural support and protection; and (2) positive steps developed countries should take on behalf of developing countries, with respect to (a) facilitating access for their products, and (b) compensating for added costs to net food importers as a result of agricultural reform.

A key question before the Negotiating Group is whether such special and differential treatment should be extended to all developing countries, or granted individually on the basis of demonstrated needs. Developed countries would like developing countries with more advanced economies to assume greater if not full obligations under the General Agreement, particularly those who export and are competitive in agricultural products.

1. Commitments by developing countries

Many proposals call for granting developing countries greater flexibility in and longer time-frames for implementing commitments to reduce agricultural support and protection. Flexibility refers to depth of cuts, products coverage, and policy coverage. Some options call for exempting development-oriented subsidies from AMS or other reduction commitments. India, for example, holds that support measures applied by the developing countries to increase productivity, stabilize prices and supplies, or subsidize consumers, should not be included among the trade-distorting measures to be eliminated or reduced. Bangladesh has submitted that new disciplines should allow for the right of the least-developed countries to provide protection, support and assistance, including assistance to export development, to the agricultural sector. Other proposals seek exemptions for specific kinds of support policies. Colombia and Thailand have stated that developing countries should not be barred from maintaining support policies, which are designed to replace illicit narcotic crops with other cash crops.

Two questions arise with respect to special and differential treatment for commitments on border protection. First, what is the general level of protection developing countries can maintain? Secondly, what form can this protection take: namely, what is the extent to which developing countries will be able to resort to quantitative restrictions?

The Cairns Group has proposed that the depth of cuts in import access barriers to be made by developing countries should be lower than the generally-agreed target. Brazil and Colombia have suggested further that the rate at which developing countries should open their markets should be determined by and be subsequent to the implementation of concessions received in markets of export interest to them.

The United States proposal which envisages final bound tariff rates at zero or low levels, would allow less-developed countries to maintain bound tariffs "at moderate levels". These would be progressively lowered to the final bound rates, as economic performance improved. The EC would accord flexibility in applying commitments to reduce protection, in terms of limited product coverage, lower magnitude of cut, and longer time-frame. India holds that tariff reduction should remain a voluntary exercise for developing countries in accordance with their individual trade, development, and financial needs. The United States proposal does not specify any special and differential treatment for developing countries under its plan to convert non-tariff measures or eliminate export prohibitions or restriction.

India proposes that developing countries should be allowed to apply quantitative restrictions on imports or exports of agriculture, as necessary. It has suggested that a provision be added to article XI recognizing the right of developing countries to apply quantitative restrictions to ensure stable and adequate supplies of basic wage goods indigenously. Honduras, El Salvador and Guatemala (CACM members) have stated that article XI:2(a) should remain in force for developing countries in order to safeguard their food security in the event of shortfalls in the world supply of basic foodstuffs.

The proposals for allowing recourse to quantitative restrictions in order to protect domestic supply management regimes (under more "operational" terms than those of XI:2(c)), or agricultural policies pursued for non-trade objectives,[20] if implemented, would be available to all contracting parties.

Article XVIII (Governmental Assistance to Economic Development) allows developing contracting parties, under certain conditions, to grant protection in order to promote the establishment of a particular industry, and to apply quantitative restrictions for balance-of-payments purposes. There have been no proposals within the Negotiating Group on Agriculture to revise this provision.

Some proposals have suggested that undertakings by developing countries with respect to export subsidies should be consistent with their development needs. The Cairns Group has proposed longer time-frames for them to implement commitments. India has suggested that undertakings by developing countries with respect to export subsidies would be conditional on a prohibition on the use of all subsidies by developed countries. Also, it has been stated that food aid should better meet the needs of dveloping recipient countries. As regards sanitary and phytosanitary measures, the Cairns Group suggests that there be longer time-frames for developing countries to comply with standards.

As already noted, some developed countries would limit special and differential treatment, with respect to internal support and border protection in general, on the basis of individual development and competitive position. The United States believes that any new General Agreement rules and disciplines should apply fully to "developing countries with relatively advanced economies and/or well-developed agricultural sectors". The EC believes that the support-reduction commitments should be applied by those developing countries, who occupy a competitive position for certain products, and have a high production volume. It further holds that "developing countries with a significant export interest or relatively advanced economies have a genuine interest in participating in such commitments, either to draw all the benefits from commitments made by others, or to better solve internal agricultural problems." The EC believes that the more advanced developing countries should participate in the "re-balancing" exercise, at least for products of major interest to them.

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[20] See section I.B.1(ii) and I. D.

2. Commitments by developed Countries

(i) Access

Many proposals call on the developed countries to reduce, on an accelerated basis, their internal support and trade barriers on products of priority export interest to developing countries. Egypt, Jamaica, Mexico, Morocco, and Peru have proposed a formula-cut approach to market access, incorporating factors for tariff harmonization, with the objective of having zero or low tariffs in developed-country markets. They have asked that preferences be improved. Internal consumption and excise taxes on products of export interest to developing countries should be eliminated by developed countries within an agreed timeframe. Voluntary export restraints and bilateral quotas on exports of developing countries should be removed on a priority basis. All other non-tariff restrictions should be eliminated and/or be made subject to strengthened General Agreement rules and disciplines. These countries have also suggested increasing discipline over countervailing or anti-dumping measures applied by developed countries to developing countries.

Many proposals have called for technical assistance to developing countries, for improving sanitary and phytosanitary standards and eradicating plant and animal diseases. This assistance could take the form of advice, credit, donations, training, and equipment. It would increase market access for their products. Moreover, the Cairns Group has proposed that compensation be granted to developing countries for trade loss, as a result of measures applied against them which are not supported by scientific evidence.

(ii) Compensation

Several studies have concluded that reductions in agricultural support and protection will lead to higher world market prices for most products in the short term, as demand expands and supplies contract. This is foreseen particularly for sugar, red meat, and dairy products. Of course, the extent of commitments on reduced support, liberalization and export competition that will be agreed to in the final agricultural package is still an open question. So too is what the response will be to improved market opportunities for developing countries in many sectors presently unexploited.

Egypt, Jamaica, Mexico, Morocco and Peru have proposed that increased financial resources be made available to the net food-importing developing countries, to alleviate the burden of increased import prices resulting from global agricultural reform, and to enhance their agricultural productivity and production.

These countries propose the following measures to offset anticipated higher food bills:

- enhancing purchasing capacity through concessional sales, including increased availability of low-cost export credits and grants;

- increasing export-earning capacity of net food-importing developing countries, through improved market access conditions for their agricultural exports, by immediate tariff and para-tariff reductions, and the phasing out or elimination of non-tariff measures or trade-distorting support;

- increased food aid, through *inter alia*, a flexible approach to the usual marketing requirements, and triangular arrangements which safeguard and promote production and exports of developing countries; and

- flexibility in structural adjustment programmes which are negotiated with international financial organizations.

Egypt, Jamaica, Mexico, Morocco, and Peru propose the establishment of a multilateral funding arrangement, to be derived *inter alia* from contributions by developed contracting parties, who will be curtailing their subsidies as a result of the negotiations. The fund would be exempt from conditionality requirements. It would remain in place until net food-importing developing countries have adjusted their internal policies to the new situation.

The net food-importing developing countries have proposed a formula for calculating the annual impact of the reform process on their food import prices. It would consist of calculating the value of net food imports in a given base period (1984/86 for example) by country, and multiplying this base value by an agreed set of coefficients.

The Cairns Group supports taking into account the needs of the net food-importing developing and least-developed countries, both within the GATT and in other multilateral agencies. It suggests that the definition of net food-importing countries be made more specific, to cover those which face critical food shortages, critical balance-of-payments problems, and critical shortages of foreign exchange reserves. Co-operation with the International Monetary Fund would be needed to determine the criteria based on balance-of-payments considerations. Food should be defined as basic foodstuff normally considered as the staple food in the country concerned, and consumed by the low-income segment of the population. Countries without critical balance-of-payments problems and with an acceptable level of foreign-exchange reserves should not be eligible for whatever measures might be agreed upon to meet the seriously affected importing developing countries.

The European Community proposes that the additional burden on net food-importing countries from price increases as a result of support reduction, be alleviated through food donations and concessional sales with an important grant element. These sales and donations would be monitored under the present article XVI notification procedures. Also there should be special financial assistance for developing agricultural production in the least-developed countries.

Honduras, El Salvador, and Guatemala have suggested that the loss of preferential access resulting from generalized liberalization of market access should be considered as a credit or contribution made by the preference-receiving developing countries. Preference-giving countries should consider the need to increase their assistance to them in compensation for loss of preferential access. Moreover, the scope for preferential trading arrangements among members of regional economic integration schemes will be limited to the extent that common external tariffs are reduced. External assistance may be required to strengthen these schemes in other ways.

H. General Agreement rules and disciplines

At the present time, what constitutes the framework of General Agreement rules and disciplines on agricultural trade is strewn over several General Agreement provisions - which are largely unenforced, inadequate or unenforceable - and several other instruments, codes, and decisions. There is under the General Agreement special treatment for agriculture, and for certain contracting parties' agriculture. Thus, a key question and preoccupation of the negotiation of improved and operationally effective General Agreement rules and disciplines is universality: comprehensive policy coverage, overall balance of rights and obligations, rules of general application.

Several participants feel that the new commitments should be incorporated into the General Agreement itself through new provisions, or through interpretative notes to the present rules with equivalent legal force thereto, rather than under arrangements or codes (with limited participation). Thus, at the conclusion of the Uruguay Round this year, if there is a political agreement on agricultural protection, this may set the stage for a codification process of the new commitments within the General Agreement.

The issue of more operationally effective General Agreement rules and disciplines is conditional on the new commitments to be reached on other issues of the negotiation. The various proposals described above imply very different consequences for the nature of any future General Agreement rules and disciplines on agricultural trade. They range from a radical re-writing of key provisions of the General

Agreement, to short-term commitments on agricultural support coupled with common interpretations of the present General Agreement rules.

With respect to internal support, the United States envisages modifying article XVI:1 and other relevant General Agreement provisions to embody the new rules proposed on the three categories of domestic subsidies. Detailed criteria for each of the three categories of policies (i.e. prohibited, permitted, to be disciplined) would be spelt out in an interpretative note to the General Agreement. Under the EC proposal, individual country plans for SMU reductions would be bound. Commitments would go beyond the existing article XVI:1 obligations, and be translated into new rules and disciplines, either within the General Agreement or by separate legal instrument. The consequences for breaching commitments and the possibilities for compensation would have to be specified. The Cairns Group has proposed that General Agreement rules and disciplines on countervailing practices should be improved. Switzerland proposed that subsidies be classified as prohibited, actionable, or permitted. It would amend article XVI to permit domestic subsidies that were necessary to attain non-commercial policy objectives of agricultural policies.

With regard to General Agreement rules on import access, the United States and Cairns Group (minus Canada) proposals would eliminate the exception under article XI:2(c) to the general ban on non-tariff barriers (under paragraph 1 of that article). It would also eliminate all waivers, derogations, and other exceptions to existing General Agreement rules. The United States proposes that variable import levies, voluntary restraint agreements, minimum import prices, and other import barriers not explicitly provided for in the General Agreement be prohibited. It also proposes that all disciplines would apply equally to State-trading entities, and has tabled in the Negotiating Group on General Agreement articles a proposal designed to strengthen article XVII.

The United States does not specify what legal form the conversion of non-tariff barriers into tariffs would take under the General Agreement, but transitional tariff quotas could be included under individual country Schedules of Concessions (annexed to the General Agreement pursuant to article II), as would the final new tariff bindings at zero or low levels. General exceptions would still be available under articles XVIII, XIX and XX.

Canada and the European Community propose, however, that recourse to quantitative restrictions for purposes of domestic supply management be retained under a revised article XI:2(c). The EC also suggests ways to cover variable levies under article XI, including the bindings of minimum import prices. Japan, Republic of Korea and Switzerland seek to allow quantitative restrictions on imports for protecting domestic agricultural production deemed necessary to meet non-trade concerns (i.e. to maintain "basic foodstuffs" or "minimum agriculture"). Some options would expand the possibilities for restricting imports of processed products. It has been suggested that minimum access levels should be fixed and possibly bound, as a floor on future quotas. Some options foresee rules and disciplines on the exportation of agricultural products covered by import protection.

With respect to export subsidies, the United States proposes a new General Agreement rule that contracting parties would not grant any form of subsidy on exports of agricultural products. Agreed annual reductions to phase out export subsidies would be contained in individual country plans similar to Schedules of Concessions. Prohibited subsidies would be defined as those specified under the Illustrative List of Export Subsidies annexed to the Subsidies Code. The United States objective is to have common rules on export subsidies for agricultural and industrial products, but it is not specified whether this would be achieved through a revision of article XVI:3 or the Subsidies Code (which applies to signatories), or both. The United States proposal would presumably signify the elimination of the equitable share obligation under article XVI:3, unless needed to discipline the trade effects of those subsidies which would not be prohibited. The long debate as to whether subsidization of the primary product component of a processed product is permitted under the current rules would cease, since export subsidies on all products, and all components thereof would be banned (except for *bona fide* food aid).

The United States and other participants propose that there be GATT guidelines to clarify the conditions under which food aid would be provided. To avoid export assistance being shifted into concessional food aid shipments, the Cairns Group proposes a General Agreement rule that all food aid be provided on a grant basis.

The European Community does not specify what legal form its proposed limitation of export subsidy amounts (to the difference between internal and world prices) would take, i.e. whether this would be a new General Agreement rule or a commitment by subsidizing participants under an agreement on agriculture. The EC proposes to define "equitable share" in more predictable terms with relation to previous shares in the average of three of the five most recent calendar years. Subsidizing exports beyond this reference level would lead to the burden of proof falling on the exporting party, to demonstrate that its acquired share was not more than its equitable share. The EC wants the subsidization of the primary product component of a processed product to be allowed under the revised rules and disciplines. It proposes that the subsidization be limited to the difference between the domestic price and the world market price of the component commodity. The EC proposes incorporating new guidelines for officially supported export credits on agricultural products under the General Agreement.

As regards export restrictions, the United States would revise article XI:2(a) to eliminate recourse to prohibitions or restrictions on exports temporarily applied to prevent or relieve critical shortages of foodstuffs. Japan sees a need for a clearer definition of the term "critical shortages". Countries like Japan note that much is being demanded of agricultural importing countries to provide secure markets, under the reform package, with little corresponding benefits of secure supplies. They believe that there should be an overall balance of rights and obligations under the General Agreement, between exporting and importing interests.

With respect to sanitary and phytosanitary measures, the United States has proposed a formal amendment of Article XX(b) to require consistency with sound scientific evidence and recognition of equivalency. A key question is whether the new disciplines and guidelines that are being proposed on these measures, should be incorporated into the Code on Technical Barriers to Trade, or be part of the GATT through some other instrument. There will undoubtedly be new procedures under the General Agreement for notification and consultation on sanitary and phytosanitary measures, and provision for greater input of technical experts to help resolve disputes.

The previous section reviewed the proposals which have been made to take into account the needs of developing countries in the agricultural reform programme. It has been generally suggested that they would undertake commitments to reduce subsidies and border protection only to the extent consistent with their development, financial, and trade needs. These commitments, if any, could be reflected, *inter alia*, under their respective individual country plan and/or schedules of concessions under the GATT. It should be expected that they would be fewer, and of a lesser order, than the commitments undertaken by developed countries.

As regards new General Agreement rules, India has stated that developing countries should be allowed to apply quantitative restrictions on imports or exports of agriculture, as necessary. It has proposed that a new provision should be added to article XI, recognizing the right of developing countries to apply quantitative restrictions to ensure stable and adequate supplies of basic wage goods indigenously.

With respect to commitments by developed countries in favour of developing countries, better access conditions on an accelerated basis should be reflected in individual developed-country schedules of concessions. These should also reflect tangible compensation for anticipated higher costs to the net food-importing developing countries. Other offsetting measures, such as new multilateral funding, would require action outside the GATT.

It may be necessary to establish some formal institution under the GATT to oversee and monitor the implementation of the commitments to reduce protection. Some participants have said it might be necessary to provide a specific procedure for dispute settlement or compensation for breach or delay in making commitments.

1. Implications of proposals for developing countries

The lack of effective multilateral disciplines over agricultural import restrictions and export subsidies has largely favoured the industrialized countries. Their support policies have had a distorting impact on world trade. Effective rules and disciplines over these practices would offer improved market opportunities for developing countries. An improved contractual basis for their trade with developed countries is also required.

II. MODALITIES FOR SPECIAL AND DIFFERENTIAL TREATMENT FOR DEVELOPING COUNTRIES

The following recapitulates the modalities for special and differential treatment for developing countries, on the basis of the proposals and considerations discussed in the previous section.

(1) Flowing from the general principles governing the negotiations developing countries will participate in the agricultural reform process in accordance with their individual trade, financial, and development needs and capabilities.

(2) The following measures will *inter alia* be excluded from reduction commitments, whether expressed in terms of specific policies or an aggregate measurement of support: income support policies linked to development objectives; environmental and conservation programmes; disaster assistance; domestic food aid; marketing programmes, market information, market promotion, inspection and grading; general research, extention and education services; resource retirement to facilitate transition; and stockpiling food reserves.

(3) Developing countries will not be subject to reduction commitments with respect to governmental measures forming an integral part of their individual development programmes, including *inter alia* aid for infrastructure development.

(4) Developing countries will not be subject to reduction commitments with respect to support policies designed to replace illicit narcotic crops with other cash crops.

(5) In cases where individual developing countries undertake commitments to reduce trade-distorting support and protection to the agricultural sector, special and differential treatment will apply. A longer period of time, possibly with a grace period, and greater flexibility in terms of policy coverage, product coverage, and depth of cuts, will be accorded to developing countries in implementing their reduction commitments on internal support and protection against imports.

(6) Developing countries shall retain the possibility to resort to export prohibitions and restrictions consistent with *inter alia* article XI:(2) and article XX(h).

(7) Developing countries shall retain the possibility to resort to protective measures consistent with article XVIII.

(8) Developing countries shall be specifically authorized under article XI to apply quantitative restrictions to ensure stable and adequate supplies of basic wage goods indigenously.

(9) Due credit shall be given to contributions by developing countries to the agricultural reform process, including any loss of preferential margins or shares experienced as as result of global liberalization.

(10) Developing countries shall undertake commitments with respect to export subsidies consistent with their individual competitve and development needs. They shall be accorded longer time-frames and flexibility in implementing their commitments.

(11) Where risk allows, developing countries shall have longer periods of time to comply with international standards with respect to sanitary and phytosanitary measures. They shall receive technical assistance for improving their national sanitary and phytosanitary conditions.

(12) Developed countries shall reduce on an accelerated basis their internal support and trade barriers on products of priority export interest to developing countries.

(13) Existing tariffs in developed countries shall be reduced to zero or low levels, on the basis of a formula with a harmonizing effect. Developed countries shall not be allowed to take new non-tariff measures. Existing non-tariff measures should be converted into tariffs, subject to maximum *ad valorem* equivalents, and reduced to zero or low levels.

(14) Developed countries shall support their agricultural sector for purposes of carrying out non-trade objectives including food security, in a manner de-coupled from production and trade effects.

(15) The terms and conditions of access in individual developed-country markets for products originating from developing countries shall be bound under the General Agreement.

(16) All food aid shall be provided on a grant basis. It shall respond to the immediate dietary and long-term development needs of the recipient countries.

(17) In the process of implementing long-term reform of agriculture, the specific needs of the net food-importing developing countries shall be taken into account, particularly those of the least-developed countries. Appropriate compensation and other measures shall be provided of higher food costs on these countries, to enhance their capacity to increase agricultural production. Additional financial resources should be made available for these purposes, which will require appropriate action by and through other multilateral organizations. Eligibility for compensation along the above lines shall be limited to those developing countries that face critical shortages of basic foodstuff (staple food consumed by the low-income segment of the population), critical balance-of-payments problems, and critical shortages of foreign exchange reserves.

(18) Developed countries shall not use food as a means of political pressure.

(19) Developed countries shall grant compensation to developing countries for trade loss suffered as a result of sanitary and phytosanitary measures applied against them, which were not supported by scientific evidence.

The above modalities for special and differential treatment have been formulated primarily in terms of developed countries and developing countries. Depending on the outcome of the final package, developing countries may need to pursue specific modalities, either individually or in combination, in the interest of the development of their agricultural sectors. This reflects the manner in which the options have been formulated before the Negotiating Group. Consideration might also be given to formulating modalities for taking into account the development dimension in the rules and disciplines of the General Agreement in a manner which avoids this dichotomy.

III. CONCLUSIONS

The agricultural negotiations are among the most crucial issues being negotiated under the Uruguay Round for developing countries. Agriculture accounts for a high percentage of their gross domestic product and trade. It is the leading source of employment in most countries.

The agricultural negotiations are also among the most complex issues being negotiated. Central to the debate is what should be the proper role of government intervention in an economic sector, its form and degree. It is the goal of some participants to achieve greater harmonization - if not standardization - of all governmental measures that can influence competition between domestic and foreign producers and products.

The catalyst for reforming the agricultural trading system under the General Agreement was the increased cost burden on the industrialized countries over the last decade to support their agricultural sectors. They have already taken measures to reduce these costs. The challenge ahead is to assure under the agricultural trade reform package that the industrialized countries do not continue to reduce their costs in a manner detrimental to developing countries. Reductions in support must be the vehicle for enchanced agricultural productivity and trading opportunities for developing countries.

TRIMS, DEVELOPMENT ASPECTS AND THE GENERAL AGREEMENT

*Hardeep Puri and Delfino Bondad**

INTRODUCTION

Since the conclusion of the Tokyo Round of multilateral trade negotiations (MTNs), there have been attempts to bring under the purview of the General Agreement a more focused consideration of a limited number of performance requirements introduced by host countries on foreign investors, particularly those in relation to the use of domestic content and to export obligation. However, several contracting parties, especially the developing countries, had resisted this attempt, maintaining that the issue of foreign direct investment (FDI) was beyond the jurisdictional competence of GATT. On the other hand, the demandeurs have argued that such requirements have effects clearly related to trade and that they should be addressed by the contracting parties.

It is against this background that the Uruguay Round negotiations on trade-related investment measures (TRIMs) need to be viewed. The scope and limits of the negotiations regarding TRIMs in the Uruguay Round were spelt out in the Punta del Este Ministerial Declaration as follows:

> Following an examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to *avoid such adverse effects on trade.*[1]

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[1] "Ministerial Declaration of the Uruguay Round", in *Uruguay Round: Papers on*

The Mid-Term Review Decision of the Trade Negotiations Committee, held in Montreal in December 1988, articulated this negotiating objective in a procedural fashion, in the form of a series of elements:

> (1) Further identification of the trade restrictive and distorting effects of investment measures that are or may be covered by GATT Articles, specifying those Articles.
>
> (2) Identification of other trade restrictive and distorting effects of investment measures that may not be covered adequately by existing GATT Articles but are relevant to the mandate of the Group given by the Punta del Este Ministerial Declaration.
>
> (3) Development aspects that would require consideration.
>
> (4) Means of avoiding the identified adverse trade effects of trade-related investment measures including, as appropriate, new provisions to be elaborated where existing GATT Articles may not cover them adequately.
>
> (5) Other relevant issues, such as the modalities and implementation.[2]

Neither the mandate nor the Mid-Term Review Decision implies that investment measures can be presumed to have trade-restrictive effects *per se*. The negotiations are expected to investigate whether such measures have effects that distort or restrict international trade. Developing countries have argued that such an investigation should confine itself to a consideration only of effects that are direct and significant. Furthermore, an examination of the development aspects of the question has been introduced as an explicit element in the negotiations, following the Mid-Term Review Decision. This would mean that questions related to TRIMs need to be examined in relation to their effects on the development policies and strategies of developing countries.

During the course of the negotiations on TRIMs, however, there has been an attempt to go beyond the carefully balanced nature of these texts and to evolve what would appear to be a regime for investment in general. This has primarily taken the form of a call for the elimination

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Selected Issues (United Nations Publication, UNCTAD ITP 10), Annex 1, p. 369. Emphasis added.

[2] "Mid-Term Review Agreements", *News of the Uruguay Round*, No. 27 (24 April 1989), p. 23.

of TRIMs themselves rather than for minimizing and avoiding the adverse effects of these measures on trade. This demand is based on the argument that the effects cannot be separated from the measures themselves. The present paper will attempt to examine this in the context of the development policies and strategies of developing countries. It will also consider whether such an attempt is warranted by the negotiating mandate or by the competence of GATT as presently constituted.

Section I of the paper examines the nature, rationale and effects of trade-related investment measures. Section II considers the relations between TRIMs and development, with respect to transfer of technology, industrialization, and prevention of restrictive business practices. Section III addresses the relation between the General Agreement on Tariffs and Trade and TRIMs. In the light of the submissions made by several participants during the negotiations, it examines the relation between a number of articles in the General Agreement and TRIMs. Section IV concludes.

I. THE NATURE AND EFFECTS OF TRIMS

Trade-related investment measures are measures adopted by host-country governments to attract and regulate foreign direct investment in their territories. They are mainly of two kinds. The first kind consists of a series of incentives designed to attract investment, such as fiscal incentives, loans, tax rebates, provision of services on preferential terms, etc. The second kind, a series of requirements or conditions, are designed to encourage the use of the investment according to national priorities. They can take the form of local content requirements, manufacturing requirements, export performance requirements, technology transfer or licensing requirements, etc. The use of these two kinds of measures may constitute the terms and conditions for the entry of investment into the host country.

Many developed and most developing countries resort to both these kinds of measures. Investment incentives, increasing the after-tax return on the owner's equity, enable countries to attract foreign direct investment in specific fields. Performance requirements, on the other hand, ensure that the operations of the firm are in consonance with the policy objectives of the host country, and that they form part of an overall strategy aimed at the country's development. The latter is particularly important for developing countries, where TRIMs are conceived as part of a strategy supportive of transfer of technology, industrialization, and better standards of living. Furthermore, several developing countries feel the additional need for employing TRIMs for the control of anti-competitive and trade-restrictive business practices. Therefore the combination of a variety of incentives and performance requirements is aimed at securing a balanced regulation and enhancement of foreign direct investment in the host country. Furthermore, the same mixture can ensure an adequate compromise between the interests of the host country and those of the investor. As Moran and Pearson point out:

> The availability of a diverse set of incentives and disincentives provides flexibility in negotiations with potential investors - additional chips - and may allow a bargain in which an incentive with high value to the investor and low marginal cost to the host country (access to the benefit of an existing free-trade zone, say) are traded for a performance requirement of a low marginal cost to the investor but high real or perceived value to the host country (an agreed commitment to make local expenditure on research and development, say).[3]

These authors further point out that TRIMs are not unique in imposing conditions of performance. A "pure" investment incentive involving, for example, a tax rebate depending on the size of local operations or which includes labour-training grants depending on the size of the labour force at the local plant, behaves like a performance requirement.[4] These kinds of *quid pro quo* can be found in several countries, both developed and developing.

The 1977 benchmark survey of the United States Department of Commerce found that 27 per cent of United States affiliates in the developing countries received one or more incentives to invest, while the figure was 25 per cent for developed countries.[5] However, developing countries imposed performance requirements on United States firms more often than developed countries - 29 per cent as against 6 per cent.[6] Stephen Guisinger, in his comparative analysis of country foreign investment strategies, argued that the differences between developed and developing countries with regard to performance requirements can be traced to variations in underlying factors such as country size and the intensity of competition in markets for FDI in which the countries operate.[7] Guisinger further argued that performance requirements were more frequent in developing countries because "the requirements for a successful application of performance requirements - a large, protected internal market - were more often found among them." This, however, did not indicate that the adverse effects of TRIMs were greater in developing countries:

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[3] Theodore H. Moran and Charles S. Pearson, "Tread Carefully in the Field of TRIP (Trade-Related Investment Performance) Measures", *The World Economy*, Vol. 11, No. 1 (1988), p. 121.

[4] *Ibid.*

[5] United States Department of Commerce, *The Use of Investment Incentives and Performance Requirements* (Washington, Dept. of Commerce, 1977), p. 1.

> However, it bears repeating that developed countries achieve much the same results using implicit performance requirements imposed through selective incentive granting that developing countries achieve through explicit performance requirements. Thus the study team could not determine whether the trade-distorting effects of government interventions to increase exports and reduce imports were more pronounced in developed or developing countries.[8]

There is not enough evidence to conclusively determine the economic effects of TRIMs. While some economists have argued that TRIMs may lead to welfare losses, both for the country of origin and for the host country, it is difficult to say whether the removal of TRIMs may not lead to other distortions in trade. The removal of TRIMs could result in other policy adjustments whose effect on trade would be hard to predict.[9] It has also been argued that TRIMs may correct certain distortions in international trade: they "may correct for the fact that the international trade of foreign-controlled firms is relatively unresponsive to differentials in international prices" and that they could "compensate for the pro-import and anti-export bias" of transnational corporations (TNCs).[10] Another positive effect of TRIMs is in speeding up a firm along a path which the management would have followed anyway. This process may result in other firms expanding small projects to full competitive scale.

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[6] *Ibid.*, p. 2.

[7] Stephen Guisinger, *Investment Incentives and Performance Requirements* (Report to the World Bank, July 1983), p. vii.

[8] *Ibid.*

[9] Moran and Pearson, *op. cit.*, p. 122.

[10] *Ibid.*, p. 123.

All this would seem to indicate that, theoretically speaking, not all TRIMs need not be trade distorting *per se*. They could be used for correcting some prevalent distortions to trade, for utilizing FDI for bringing infant industries to maturity, or for "stimulating exports with more efficient import substitution".[11] And, theoretically, the removal or prohibition of TRIMs *per se* may not lead to a reduction of distortions to trade. Given the corrective effect of many of the TRIMs, their removal could very well result in an increase in trade-distortionary effects.

However, several developed countries have argued that TRIMs can have a "strong dampening and distorting effect on world trade", by distorting the pattern of trade and investment flows. The empirical evidence on the incidence and economic effects of TRIMs is incomplete, but the few surveys conducted in this area do not seem to corroborate the claim of a "strong dampening and distorting effect". The 1977 benchmark survey of the United States Department of Commerce found only 14 per cent of the United States firms abroad subject to performance requirements.[12] The Guisinger study, far more limited in its investigations, covered only 74 investment projects and found 38 of them to be subject to such requirements.[13] The empirical investigations of the trade effects of TRIMs are methodologically problematic, since at best they compare "actual operations of firms with a hypothetical world in which target countries have no performance requirements, while all other countries are allowed to retain investment incentives."[14] Even then, the trade-impact of TRIMs would appear to be exaggerated in negotiations than is actually warranted by the available empirical findings. The Guisinger study concluded that TRIMs resulted in altering the location of only 4 out of the 74 firms examined.[15] In sectors such as computers and petrochemicals, TRIMs did not have a significant effect on patterns of production and trade, while in automobiles and food processing, it seemed to have had some effect. The ITC study showed the reduction of United States exports due to TRIMs to be 1.7 per cent in petrochemicals, 0.9 per cent in automobiles, 0.5 per cent in computer and office equipment.[16] The OPIC study also concluded that performance requirement *per se* did not significantly affect the pattern of trade: in 83 per cent of the cases they were of no significant influence.[17]

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[11] *Ibid.*, p. 124.

[12] United States Department of Commerce, *op. cit.*, p. 1.

[13] Guisinger, *op. cit.*, p. vi.

[14] Moran and Pearson, *op. cit.*, p. 126.

[15] Guisinger, *op. cit.*, p. 49.

In the context of the above discussion, the aim of the negotiations on TRIMs in the Uruguay Round can be placed in clearer perspective. It is the identification of such direct and significant adverse trade effects of TRIMs and to find means for avoiding them, rather than the prohibition or removal of TRIMs *per se*. It would appear that there is nothing in the mandate or in the nature, rationale and effects of TRIMs to warrant such attempts at blanket prohibition or removal of the performance requirements *per se*. Furthermore, the Ministerial Mid-Term Decision unequivocally specifies that a consideration of the development aspects of this issue should be an integral part of the negotiations. Such a consideration will reveal adequate justification for several TRIMs in the context of the development policies of developing countries. It is to this set of issues that we shall turn next.

II. TRIMS, DEVELOPMENT AND RBPS

In an earlier paper, it was argued in detail that several TRIMs are introduced by developing countries with specific development objectives and that their prohibition can result in a frustration of these objectives.[18] To summarize some of the arguments, countries with persistent balance-of-payments difficulties impose export performance requirements as well as local content requirements in the light of their foreign exchange situation. Trade balancing requirements may also help in this, establishing a balance between the imports and the exports of firms. Furthermore, local content requirements may also induce foreign firms to envisage extending the range of products manufactured locally, thus helping to improve product quality and contributing to the process of industrialization. Technology-transfer and licensing requirements are aimed at acquiring improved technology that is crucial for development. Domestic sales requirements are devised for ensuring that certain products are available in sufficient quantity and at appropriate prices for the needs of local entities. All these measures form part of a coherent development strategy aimed at industrialization, transfer of technology and better living conditions.

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[16] Moran and Pearson, *op. cit.*, p. 126.

[17] *Ibid.*

[18] See Hardeep Puri and Philippe Brusick, "Trade-Related Investment Measures: Issues for Developing Countries in the Uruguay Round", in *Uruguay Round: Papers on Selected Issues, op. cit.*, pp. 203-19.

In addition to the reasons mentioned above, developing countries need to use TRIMs to address the trade-distorting and anti-competitive practices of corporate entities. A restrictive business practice is an unfair trading practice adopted by one firm, alone or in collusion with other firms, to attain or abuse a dominant position of market power. These practices, aimed at eliminating competition, and at artificially enhancing the firm's bargaining power in relation to dealers and customers, create serious imperfections and distortions in international production and trade.

This is borne out by the fact that the contracting parties to the General Agreement, in the late fifties, "recognized that business practices which restrict competition in international trade may hamper the expansion of world trade and the economic development of individual countries and thereby frustrate the benefits of tariff reduction and of the removal of quantitative restrictions, or may otherwise interfere with the objectives of the General Agreement on Tariffs and Trade." Although the contracting parties did not succeed in resolving the matter, it is clear that investment measures can be used as positive instruments to neutralize the effects of business practices such as:

- Restrictions on purchases (for example, tied purchasing arrangements);
- Restrictions on sales (for example, prohibitions on export or specification of areas within countries, or externally, to where sales are permitted);
- Restrictions on channels to be used with respect to sales (for example, the channelling of sales through marketing subsidiaries and

exclusive dealing arrangements as between parents and subsidiaries with regard to the distribution of their products);

- Restrictions on activities to be performed (for example, limiting the size of production or limiting activities to selected processes such as assemblies and, in consequence, the enterprise determining the extent of value-added to be contributed by various entities of the enterprise to the final product);
- Price manipulation in import and export transactions, in particular through the use of transfer price mechanisms; and
- Restrictions on export and imports through the use of such business practices as price-fixing, market-allocation arrangements and refusal to deal.

Export requirements, for example, can be used by governments of host countries to counter international market allocation by foreign enterprises, as in the case of cartels deciding to restrain or block exports from a given country, or of TNCs who might allocate markets among their subsidiaries. Local content requirements, reducing the import of intermediate inputs, may limit the scope of transfer pricing and differential or predatory pricing by foreign suppliers aimed at eliminating local production. Trade-balancing arrangements also strengthen the position of domestic producers in relation to foreign suppliers of intermediate inputs and thus enable them to combat international market-allocation arrangements among foreign firms, long-term exclusivity contracts and tied selling arrangements. Domestic sales requirements constitute a countermeasure to restrictive business practices such as cartel pricing and refusal to deal. Manufacturing requirements and limitations, reserving certain markets for local firms, provides a "countervailing market power" against the international market allocation of TNCs, thus ensuring the survival of local producers who might otherwise be eliminated by foreign competition. Similarly, product mandate requirements, obliging the investor to earmark a specific product for export, form a government-imposed market allocation to counter the enterprise-to-enterprise market allocation of TNCs.

It is thus amply clear that these illustrative corporate practices, if not addressed by host countries, may retard development efforts or impose difficulties on the economies of host countries, particularly the developing countries. Prohibiting or restricting the use of such investment measures would not therefore address the real source of trade restrictions and distortions in international commerce. The alleged adverse trade effects of trade-related investment measures should therefore be pursued in terms of their relationship with the aforecited practices, to facilitate the attainment of the objectives of the General Agreement.

III. GENERAL AGREEMENT, DEVELOPMENT AND INVESTMENT

The inclusion of development aspects among the elements enumerated in the Montreal decision on TRIMs reflects certain policy considerations which have their origins in several provisions of the General Agreement. Among these provisions underpinning development are the objectives embodied in Part IV of the General Agreement, when the contracting parties, *inter alia,*

- recalled that the basic objectives of the Agreement include the raising of the standards of living and the progressive development of the economies of all contracting parties;
- considered that the attainment of these objectives is particularly urgent for less-developed contracting parties; and,
- noted that the contracting parties may enable less-developed contracting parties to use special measures to promote their trade and development.

Additionally, it is recognized that "economic development is consistent with the objectives of the General Agreement, and that the raising of the general standard of living of the underdeveloped countries which should be the result of economic development will facilitate the attainment of the objectives of the Agreement".[19]

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[19] *BISD*, Third Supplement, pp. 179-80.

The General Agreement, as presently drafted, constitutes a multilaterally negotiated legal instrument with a clearly defined set of rights and obligations for the regulation of international trade in *goods*. It must therefore be emphasized that despite the fact that the term "international trade" has been defined in the domestic legislation of the United States to include both *goods* and *services* and *foreign direct investment* if such investment has implications for trade in goods and services, there is as yet no international consensus on such a wide scope for defining international trade, either in the domestic legislation of many other contracting parties or in terms of GATT case law. The only dispute which came before a GATT dispute panel was the case brought by the United States against the administration of the Foreign Investment Review Act (FIRA) of Canada. Even in this case, a large number of delegations had expressed doubts whether the dispute between the United States and Canada was one for which the GATT had competence since it involved investment legislation, a subject not covered by the GATT. The Council had finally decided to allow the Panel to proceed with its work, with the terms of reference as agreed on the presumption that the report of the Panel would be limited in its activities and findings to within the boundaries of the General Agreement. Reservations and statements made by delegations have been placed on record.[20] As such, positions expressed to the effect that particular articles of the General Agreement may or may not be applicable in the context of trade-distorting or restrictive effects of investment measures are in the nature of suggestions, and are not necessarily shared by other contracting parties or backed by case law. They need to be seen against the background of this one dispute settlement case. The Panel had only found that Canada's practice of allowing certain investment, subject to FIRA, conditional upon written undertakings by the investors to purchase goods of Canadian origin or goods from Canadian sources, was inconsistent with article III:4 of the General Agreement. Article III:4 stipulates that imported products shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

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[20] *BISD*, 30th Supplement, pp. 141-42.

We shall examine below a number of articles of the General Agreement that have been invoked during the negotiations as being applicable to TRIMs. We shall argue that in these cases, the articles do not pertain to investment at all, and that the extension of their applicability to TRIMs can have implications that go beyond the negotiating mandate.

1. Article I

It has been suggested by some participants that TRIMs have discriminatory trade effects, both on imports and exports because they are imposed on particular companies that happen to invest in a given country and that they are negotiated on a case-by-case basis. As part of this argumentation, it has been alleged that there is virtual absence of transparency in the application of TRIMs, making it virtually impossible for a contracting party to have any assurance that it is being treated in a non-discriminatory way.

Article I contains the key, general most-favoured-nation (MFN) principle which stipulates that with respect to customs duties and charges, rules and formalities in connection with importation and exportation, and internal taxes and other internal regulations, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties. Article I, along with the national treatment principle contained in article III, aims to ensure equality of treatment of products with respect to the measures referred to above. Clearly, article I deals with the avoidance of discriminatory trade measures and would be violated if a specific trade measure discriminates between goods on the basis of country-origin.

Investment measures imposed by governments do not fall within the ambit of article I for a number of reasons. Firstly, investment measures are not imposed at the border. Secondly, even if an investment measure could be said to be trade distorting, article I is not relevant because this article deals with discriminatory trade measures, as implying discrimination between one country and another. It does not deal with discriminatory *effects*, if any. Thirdly, investment measures relate to issues of foreign capital treatment, industrialization policy, or balance-of-payments policy. The first two do not fall within the competence of GATT and, in respect of the third, there are clear balance-of-payments exceptions for developing countries. Decisions by governments to accept foreign direct investment from a particular source are often taken on grounds and criteria which may involve considerations other than of an economic or commercial nature. Finally, investment meausres, imposed as they are by sovereign governments for a variety of reasons not necessarily linked to trade, cannot in their entirety be regarded as trade measures. Since article I deals only with discriminatory trade measures as applying to goods, it cannot *ipso facto* be said to apply to investors *per se*.

The applicability of article I to investment measures still remains to be demonstrated. Even if such investment measures have some trade distorting effects, these are neither direct nor significant and, in any case, involve situations other than for which article I was drafted. If article I were made applicable to decisions relating to investment opportunities this would result in host countries losing their flexibility in the choice and source of investments.

2. *Article II*

Article II contains both general and specific provisions aimed at protecting the value of tariff concessions. Its general language reaches broadly to require each contracting party to accord to the commerce of the other contracting parties treatment no less favourable than that provided for in tariff schedules. It has been argued that different kinds of TRIMs could increase the cost of importation. For instance, it has been alleged that trade-balancing requirements which require a particular level of exports before import licences are granted can impose an additional cost on imports, thus undermining the value of a tariff concession. Considering that investment measures are imposed by governments with specific objectives, this argument would have the effect of broadening the coverage of the expression "all other duties or charges" in para. 1(c) of article II beyond the intention of the article, which clearly relates to "on or in connection with importation".

3. Article III

Article III contains the national treatment principle. Article III:4 stipulates that imported products shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of regulations affecting their internal sale, offering for sale, purchase, transportation, distribution or use. Article III:5 prohibits the use of internal quantitative regulations which directly or indirectly require the supply of products from domestic sources.

As already stated, the FIRA Panel found written undertakings by the investors to purchase goods of Canadian origin or from Canadian sources to be inconsistent with article III:4. In addition to the reservations placed on record by some contracting parties, Argentina had, in a submission before the Panel, argued *inter alia* that the dispute involved two developed contracting parties. The provisions and arguments invoked against Canada were not necessarily those which could be invoked against developing countries, considering the exception which these countries are entitled to under the General Agreement in order to promote the establishment of a particular industry. Argentina asked the Panel to take this into account in its deliberations. In its findings, the Panel gave due recognition to the submission by Argentina and stated that

> in any dispute involving less developed contracting parties, full account should be taken of the special provisions in the General Agreement relating to these countries (such as article XVIII C). The Panel did not examine the issues before it in the light of these provisions since the dispute only involved developed contracting parties.[21]

When the Panel report came up for consideration in the GATT Council, many developing countries reiterated this point and reserved their acceptance of the Panel report on the clear understanding that in the event of a dispute involving less developed contracting parties being brought before GATT, the special provision relating to them would need to be considered.

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[21] *Ibid.*, p. 158.

It could be argued that developing countries have no special dispensation in their favour in relation to their obligations under article III. It may be argued that the need for protection of infant industries requires the invocation of the procedures of article XVIII C which provides for prior approval and compensation to other countries. However, it has been pointed out by some participants in the negotiating group that since article III deals with discrimination between imported and domestic goods, it does not deal with TRIMs which are production measures. It can also be argued that investment measures are imposed by developing countries in the broad context of development policies, and that if at all there is an effect on trade, such effect would have to be direct and significant to motivate contracting parties to seek recourse to existing remedies.

4. Article VI

Article VI deals with and prescribes conditions under which counter-measures (anti-dumping and countervailing duties) can be applied if dumping or subsidization causes or threatens material injury to an established industry or materially retards the establishment of a domestic industry.

Article VI has been cited as being relevant to several TRIMs. Some illustrative examples are:

- Investment incentives that reward the attainment of export targets; and
- Requirements that increase exports.

The provisions of article VI of the General Agreement have been amplified in the Tokyo Round Anti-Dumping Code - which replaced the earlier 1967 instrument - and the Tokyo Round Subsidies and Countervailing Measures Code. However, neither the General Agreement, nor these Codes prohibit dumping and subsidization *per se*. It is only if dumping results in or threatens material injury to an established industry of another contracting party that counter-measures, under certain prescribed conditions, can be imposed. (The situation in respect of countervailing duties is somewhat different and will be examined separately.) As such, remedies against injurious dumping already exist. In any case, certain TRIMs which are alleged to have adverse effects (increasing exports through measures akin to dumping) would require the measure and the alleged adverse effect to be examined on a case-by-case basis. Existing remedies under article VI or the Anti-Dumping Code can be utilized where it is demonstrated that the TRIM in question has resulted in a situation of dumping causing or threatening material injury.

In the case of subsidies, the situation is somewhat different. Article XVI:4 of the General Agreement and article 9 of the Subsidies Code prohibit contracting parties from granting any export subsidy on manufactured products. Developing countries are exempt from this prohibition, provided that they have entered into a commitment to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with their competitive and development needs (articles 14.2 and 14.5 of the Code). In the case of subsidies on certain "primary products",[22] there is no blanket prohibition. In this case, the commitment is not to grant any export subsidy on such products in a manner which results in the signatory granting such subsidy having more than an equitable share of export trade in such products. Article XVI:3 of the General Agreement and article 10 of the Code provide guidance on how the concept of "more than an equitable share" is to be determined.

Neither of the situations listed above would appear to apply to TRIMs maintained by developing countries. In addition, the provisions of article 11 of the Code (which deal with subsidies other than certain export subsidies) and article 14 (which deals with developing countries) sustain the position of developing countries. Article 11 recognizes that subsidies, other than export subsidies, are widely used as important instruments for the promotion of social and economic policy objectives. Some illustrative objectives are cited in article 11. There is, however, a recognition that such subsidies may cause or threaten to cause injury to a domestic industry of another signatory, or may nullify or impair benefits accruing to another signatory under the General Agreement. Accordingly, signatories should seek to avoid causing such effects. The Code stipulates that such subsidies do not create the basis for action, under the General Agreement, as interpreted by the Code. This is of course without prejudice to the rights of signatories under the Code. In overall terms, the language of article 11 would suggest that whilst some of these subsidies could be countervailable in case injury can be demonstrated, the mere existence of such subsidy practices cannot lead to a presumption of nullification and/or impairment. Article 14 moreover contains an explicit recognition that "subsidies are an integral part of economic development programmes of developing countries".

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[22] These are defined as any product of farm, forest or fishery, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade. The reference to "or any mineral" originally found in article XVI was subsequently removed.

Given the nature and intent of TRIMs imposed by developing countries, it is clear that trade effects, if any, are not similar to those for which article VI was designed. In any case, if it can be demonstrated that the adverse trade effects are direct and significant, a conclusion which would need to be arrived at on the basis of a case-by-case examination, then the remedies available under the General Agreement would appear to be sufficient.

5. *Article VIII*

Article VIII limits fees and formalities to the costs of services rendered in respect of imports. Like article II, it reflects the desire of the drafters of the General Agreement to obligate countries to employ duties should they wish to protect domestic industries or products. The article bans "fees and charges of whatever character" (other than those imposed consistently with articles II and III) to the extent that they exceed the approximate cost of services rendered. Such fees and charges are not to represent indirect protection to domestic products.

TRIMs, whether they are designed to attract foreign direct investment or performance requirements imposing conditions thereon, do not take the form of fees or charges, as commonly understood in

GATT. As such, article VIII would appear to have no relevance in the context of TRIMs.

6. Article X

Article X, the central "transparency" clause of the General Agreement, contains provisions requiring prompt publication of laws, regulations, judicial decisions and administrative rulings of general application. This is to enable governments and traders to become acquainted with administration of trade regulations and specifically those pertaining to requirements, restrictions or prohibitions, that are generally applicable, and that affect the sale, distribution, transportation, insurance, warehousing, inspection, exhibition, processing, mixing or other use of imports or exports or on the transfer of payments therefor.

The requirements of article X should be distinguished from the general need for transparency which is a basic principle of GATT. Whilst the need for transparency in the matter of trade regulations is most desirable in the interests of governments and economic operators, the precise applicability of article X to investment measures which relate to issues of foreign capital treatment, industrialization policy, development policy, or balance-of-payments policy, none of which fall within the competence of the GATT, is not clear. Moreover, since TRIMs are imposed by governments on foreign private investors, there are grounds for serious doubt whether the underlying conditions of article X which deal essentially with government measures, as described above in relation to merchandise trade, would be applicable. Most developing countries provide transparency to their investment regimes but since the focus of discussions cannot be on the investment regimes of countries, it is not clear as to how article X would be applicable.

7. Article XI

Article XI contains provisions on the application of quantitative import and export restrictions and requires the general elimination of quantitative restrictions. This article deals with restrictions on importation or exportation of products. It deals with the act of importation and not with measures affecting "imported products" that are dealt with under article III. This view, that the General Agreement distinguishes between measures affecting the "importation" of products which are regulated in article XI:1, and those affecting "imported products" which are dealt with in article III was also upheld by he FIRA Panel report. Hence TRIMs which have the effect of restricting or constraining imports cannot be regarded as violating article XI. Such measures *do not prevent* importation by the concerned company. In any case, developing countries with balance-of-payments problems have a specific dispensation or exception in their favour for maintaining quantitative restrictions, under certain terms and conditions, under article XVIII.

8. *Article XVI*

Article XVI contains provisions on the use of subsidies. Some provisions of article XVI have been considered in the section dealing with article VI. Furthermore, article XVI is already under consideration in the negotiating group on subsidies and countervailing measures. The proposal by some participants to classify TRIMs as outrightly prohibited, permitted yet actionable, etc., along the lines of the Mid-Term Review Decision on subsidies presumes that all TRIMs have effects equivalent to subsidies. This assumption appears to be untenable. In this context, it is necessary to emphasize the existing distinction between subsidies on manufactured products for which developed countries have undertaken a commitment not to grant export subsidies (which does not apply to developing countries) and the provisions relating to export subsidies on certain primary products on which there is no ban even for developed countries. As in the case of subsidies, any action against TRIMs, in the context of article XVI, must be based on an examination of facts, on the legal provisions of the General Agreement and the Code, on the alleged adverse effects being direct and significant, and on these so-called adverse effects resulting in or threatening material injury. In the event of clearly demonstrable adverse effects, existing remedies could be applied. There appears to be no basis for additional provisions since article VI:1 provides for consultation in the event of serious prejudice.

9. Article XVII

It has been suggested that article XVII, which deals with State-trading enterprises, contains a number of principles which create rights in the General Agreement that are directly relevant to the trade-restricting and distorting effects of investment measures. Article XVII:1(b) requires State enterprises to make purchase or sales involving either imports or exports solely in accordance with commercial considerations. Article XVII had been examined by the FIRA Panel. This panel having reached a decision on purchase undertakings in relation to article III:4, did not consider it necessary to make a specific finding on the interpretation of article XVII:1(c) in the context of this case. It did not reach a separate conclusion, therefore, regarding the consistency of purchase requirements with this provision. Interestingly, as regards the undertakings by investors to export specified quantities or proportions of their production, the Panel concluded that article XVII:1(c) was not applicable. It found that there was no provision in the General Agreement which forbids requirements to sell goods in foreign markets in preference to the domestic market and, in particular that the General Agreement does not impose on contracting parties the obligation to prevent enterprises from dumping. As a result, the Panel's view was that Canada was not acting inconsistently with any of the principles of non-discriminatory treatment prescribed by the General Agreement in accepting investment proposals on the condition that the investor export a certain quantity or proportion of production. Therefore, it was not necessary to proceed a step further and examine the export undertakings in the light of the commercial considerations criterion of article XVII:1(b).

10. Article XVIII

This article deals with governmental assistance to economic development. It has been listed for review in the negotiating group on GATT articles where the attempt, in particular, is to recast the provisions of section B of this article and tighten the procedures for its invocation. The attempt appears to be to encourage countries to move from invocation of article XVIII B to article XVIII C dealing specifically with protection of infant industries which would involve prior approval of contracting parties and provision for compensation.

If the provisions of article XVIII B are diluted, the problems of many developing countries in GATT, which have balance-of-payments problems of a structural and persistent nature, would be aggravated. The proposals for review of this article have been examined in detail by Frances Stewart in an UNCTAD publication on the Uruguay Round.[23] This paper concludes that developing countries still need the right to impose quantitative restrictions for BOP purposes. Developments since this article was introduced in 1957, both in the external environment and in knowledge about economic behaviour, reinforce rather than reduce this need. The provisions of article XVIII form part of exceptions from certain GATT obligations in favour of developing countries, and as such should be fully respected, particularly with reference to the balance-of-payments effects of foreign direct investment and to the desirability of aligning the operations of foreign investors with each country's development and industrialization programmes.

11. Article XXIII

This article provides remedies when a party considers that

> any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the agreement is being impeded as a result of the . . . application by another contracting party of any measure whether or not it conflicts with the provision of this Agreement . . .

As we have argued above, the General Agreement deals with trade in goods, not with investment. Hence it cannot be said that all trade-related investment measures would *ipso facto* fall under the provisions of article XXIII. Therefore it would be necessary to establish that the merchandise trade effects of investment measures are:

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[23] Frances Stewart, "Proposals for a Review of GATT Article XVIII: An Assessment", *Uruguay Round: Papers on Selected Issues* (United Nations Publication, UNCTAD/ITP/10), pp. 1-43.

- restricting and distorting;
- direct and significant;
- directly related to the operation of specific articles in the General Agreement;
- that their effect is such as to lead to nullification and/or impairment of benefits, accruing to another contracting party.

Since investment measures are maintained by governments in the context of foreign capital treatment, industrialization policy, development policy, or balance-of-payments policy, the relevance of article XXIII would need to be examined in the light of the above.

IV. CONCLUSIONS

When the issue of TRIMs was first raised for negotiations in the Uruguay Round, the aim was to address the trade-related effects of a limited number of performance requirements. However, the scope of many of the proposals put forward during the negotiations clearly appear to go beyond the limits of this initial objective and seem to cover not just the trade-related effects, but the investment measures themselves. It has been argued by several developed contracting parties to the General Agreement that effects cannot be clearly disengaged from measures, and that the negotiations should address the measures as well. For several developing countries, who use investment measures to attract and regulate foreign direct investment to support their domestic resource mobilization, this argument clearly poses vital questions. They feel that an attempt to create an international framework on investment measures *per se* would seriously threaten their development efforts, since TRIMs form an integral part of the development strategies and balance-of-payments policies of many of these countries. They also feel that trade negotiations can hardly be the appropriate fora for evolving an international investment regime. An attempt to evolve such a regime can result in asymmetries, since there will be no obligations on investors in return for the disciplining of TRIMs. A consideration of TRIMs, in isolation from the context of development objectives and of restrictive business practices, can only create further difficulties for developing countries. It is in this light that the applicability of existing provisions of the General Agreement to TRIMs need to be considered.

TRADE-RELATED INTELLECTUAL PROPERTY RIGHTS: UNITED STATES TRADE POLICY, DEVELOPING COUNTRIES AND THE URUGUAY ROUND

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I. THE POLITICAL ECONOMY OF INTELLECTUAL PROPERTY RIGHTS

The demand for stricter protection of intellectual property rights (IPRs) has risen in recent years to become a leading issue for United States trade negotiators. Whether one focuses on United States trade policy at the bilateral or the multilateral level, the issue is near the top of the agenda, and threatens to cause continuing friction between the United States and developing countries. This friction can be expected to continue, no matter what the results of the Uruguay Round negotiations.

The purpose of this paper is to address the problem of intellectual property rights at both the theoretical and the practical levels, examining the distinct interests of countries at differing levels of economic development and political influence. This introductory chapter takes a step back from the more immediate policy issues, in order to establish an analytical framework within which to examine these questions. Subsequent sections of this paper address themselves more directly to the issues at hand, but in a manner consistent with the ideas presented in the pages that follow.

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A. Economic interests and support for intellectual property rights

To understand the political economy of trade-related aspects of intellectual property rights (TRIPs), it is first necessary to recognize the simple fact that *patents* are government-sanctioned monopolies for intellectual property owners. Patents are intended to introduce excludability into the otherwise public good of information, in order to prevent the diffusion of this property through imitation. Like other monopolies, they create inefficiencies, and permit monopolists to extract rents. Expressing the issue in these terms is offensive to the defenders of intellectual property, as well as their allies in the academic community. An inquiry into the nature of this monopoly should not be clouded, however, by the sometimes biased terminology employed in scholarly and policy debates. To speak of intellectual property *rights*, as opposed to intellectual property *privileges*, tends to imply that IPRs protection is a universal obligation, rather than an elective option. This paper attempts to examine the political economy of TRIPs through an examination of concrete economic interests, rather than through abstractions.

The economic debate over the intellectual property protection divides those scholars who stress the benefits that stem from the enforcement of this monopoly, and those who emphasize the costs. According to the liberal tradition, the enforcement of intellectual property is an acceptable and necessary infraction of the anti-monopolistic injunction. Proponents of this school argue that the state must support an adequate return on research and development costs, and thus provide a socially necessary incentive for innovators and entrepreneurs by establishing and enforcing temporary monopolies for inventors. The monopoly rents that innovators thus derive, and the costs that the state incurs in enforcing intellectual property rights, are the price that society pays for progress. "Patents explicitly prevent the diffusion of new technology", according to one author, "to guarantee the existence of technology to diffuse in the future".[1] The position advanced by the United States and other industrialized countries is consistent with this tradition. Another school stresses that IPRs are no different from other monopolies, insofar as they confer abnormally high profits upon their owners, invite abuse, and restrict the spread of technology and its benefits. Scholars in this tradition are concerned not that the absence of patents will result in the underprovision of innovation, but rather that the patent system promotes a suboptimal diffusion of innovations.[2] This argument is extended at an international level by economists and statesmen in some developing countries, who believe that distributive justice and economic development require that technology be transferred more freely.

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[1] Robert Benko, *Protecting Intellectual Property Rights: Issues and Controversies* (Washington, D.C., American Enterprise Institute, 1987), p. 19.

It would be erroneous to assume, however, that the economic policies pursued by a country stem directly from the economic ideas debated in the scholarly community. These policies evolve as a consequence of rational economic interests. Property rights are not simply a function of a self-regulating market: the market, and the property rights that it recognizes (whether tangible or intangible), are defined and enforced through a political process. It is the thesis of this section that the global IPRs regime, and the positions taken on this subject by individual countries, are shaped in much the same fashion as the global trading regime. This thesis is presented first by reference to a simple model of policy development, which is then applied to historical and current cases. The model and the observations that follow help to explain both the fundamental reasons for the United States emphasis on this issue, and the means that the United States has employed in pursuit of its goals.

1. The model

A simple model is presented here that attempts to illustrate the political economy of TRIPs, both within and among nations. The model is derived in roughly equal measure from two fundamental theories of international political economy: the product-cycle theory of industrial development, and the hegemonic-stability theory of international economic regimes. Taken together, these two theories explain the interests of industries in the protection of intellectual property, the translation of these interests into public policy, and the conflict between countries at differing levels of economic sophistication and political influence. We will develop this theme first by examining the interests of firms and industries in TRIPs, and then by extrapolating from these sectoral observations to the international system. Briefly stated, the model suggests that the same hegemon that promotes a relatively open trading system early in its ascendancy can be expected to seek a global IPRs regime in the later years of its dominance, but that this effort will face resistance from developing countries. The most rational strategy for the hegemon to pursue, in the face of this resistance, is to create linkage between the treatment its intellectual property receives abroad, and the treatment that it gives to foreign products in its own market.

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[2] See for example John Jewkes, David Sawers, and Richard Stillman, *The Sources of Invention* (New York, St. Martin's Press, 1959).

The interests of any given firm or industry in intellectual property protection are easily understood, as are those of arch-typical developed and developing countries. Producers in an industry will naturally support strict enforcement of intellectual property rights to the extent that they have developed high technologies, innovations, and trade secrets, and rely upon the restriction of these developments in order to maintain a competitive edge. If one assumes that the interests of private industry influence government policy, and that an industrialized country is composed largely or entirely of advanced industries, then it is axiomatic that the country will support a strict IPRs regime. By contrast, if a developing country is composed entirely of nascent industries, which depend upon borrowed rather than locally-developed technology, that country will have an equally strong interest in opposing or evading the establishment of such a regime.

The relationships are complicated, however, by the fact that the interests of a national economy in IPRs are not static. These interests are subject to an evolutionary process, in which a country's incentive to enforce intellectual property rights can be seen *ceteris paribus* as a natural product of internal economic and political developments. In the domestic debate over intellectual property rights, there will always be factions that stand to gain from a strict property regime (especially the local innovators, or those who are economically associated with foreign owners of intellectual property), and those who stand to lose from restrictions on the spread of intellectual property (especially those who would imitate the new product or process, or market the products that imitators produce). These parties can be expected to promote their respective positions in the domestic political process, by demanding that the national authorities establish an intellectual property regime that best suits their own interests.[3] "Economic development", in this sense, can thus be defined as the process through which the economic and political influence of innovators comes to exceed that of imitators. Once this watershed has been reached, one can expect the country's IPRs regime to move closer to the liberal ideal.

The model can now be extended from the national to the international scale, by examining the conflicting economic interests of individual countries. The observations made above suggest that in a world composed of many different countries at distinct levels of economic size and development, the more economically advanced countries will have stricter domestic IPRs regimes than will the less advanced countries. By contrast, the smaller and less industrially advanced countries will naturally prefer less strict domestic regimes, which encourage the transfer of foreign technology either through unilateral measures (i.e. "pirating") or by a negotiated means of transmission (e.g. licensing and transfer agreements). The differing intellectual property regimes of these countries will come into conflict through the mechanism of trade. If the more economically advanced countries face competition from imitators, they will naturally complain to their governments over foreign violations of the intellectual property.

This conflict of interests can be clarified by reference to the well-known "product cycle" of industrial development. Raymond Vernon suggested that any given industry in an advanced industrialized country will pass through the following stages:

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[3] Consumers might arguably play an important role in this process, as they would ultimately benefit from wider availability of knowledge-intensive products, but as a practical matter they will not ordinarily be highly active parties. The theory of collective action suggests that although consumers share an interest in the outcome of the intellectual property debate, they will be prevented by the public-goods problem from organizing effectively, and hence will not exercise any real influence over the case. The issue will therefore be cast primarily as a dispute between innovators, imitators, and other business interests. See Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, Massachusetts, Harvard University Press, 1965).

- Innovation of a product, introduction in the domestic market, and growth of local sales.

- Saturation of the domestic market, and exportations to foreign markets. The first export markets will be countries similar to the domestic market (i.e. other industrialized countries), followed by countries with dissimilar demand structures (i.e. developing countries).

- Foreign investment by the industry, for provision of the product in foreign markets.

- Export of the product from the foreign countries to the original home market.[4]

Vernon's cycle assumed that this process would remain within the control of the multinational corporations that pioneered an industrial enterprise. Even when they reach the stage of exportation from foreign countries into their home market, their control of the intellectual property incorporated in the goods (including both the industrial property needed for production, and the "brand loyalty" of trademarks) assures that the enterprise remains profitable for them. If one assumes, however, that intellectual property is as mobile as other means of production, then the third and fourth stages of this product cycle may be entirely different: the new production established abroad may be founded by foreign imitators, rather than by the innovating corporations, and these imitators might eventually compete in both the home and foreign markets. In order to prevent the product cycle from moving against their interests, the original innovators will naturally insist that foreign countries respect their intellectual property rights. This conflict is likely to be particularly intense with those developing countries that are making the most rapid transition to industrialization. The other industrialized countries will generally have intellectual property regimes that prevent the establishment of IPRs-violating industries, while the lesser developed countries will generally not have the requisite industrial base.

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[4] Raymond Vernon, *Sovereignty at Bay: The Multinational Spread of U.S. Enterprises* (New York, Basic Books, 1971). See also James Kurth, "Political Consequences of the Product Cycle: Industrial History and Policy Outcomes", *International Organization*, Vol. 33, No. 1 (1979), pp. 1-34.

How then will the conflict between the more advanced and mid-level countries proceed? For this step in our model, we move on to the theory of hegemonic stability.[5] The theory was developed to explain why the public good of open markets is sometimes provided, and sometimes not. According to this school of international political economy, the regime governing economic relations between countries will be determined above all by the balance of power. In a hegemonic system, the leadership and enforcement functions fall largely (though not exclusively) on the shoulders of the hegemon. Markets will be relatively open when there is a dominant country to establish and enforce free trade, but that markets will be relatively closed when there is no hegemon. For example, free trade reigned during most of the nineteenth century, when Britain was in its hegemony, and was re-established by the United States following the Second World War. The theory also implies that the continued existence of free trade is tied to the fortunes of the hegemon: if the dominant country should lose its competitive position, and enter into a period of decline, that country will grow progressively less interested in supporting free trade. If other countries do not begin to play a greater leadership role, the system may revert to closed markets.

The theory of hegemonic stability can be extended to examine its implications for TRIPs. Both intellectual property and its protection are public goods, and nations differ greatly in their willingness and capacity to supply these goods. Nations that are economically advanced and politically powerful have both the motive and the means for compelling countries that are economically less sophisticated and politically more vulnerable into accepting regimes or bilateral agreements that recognize and enforce these property rights. In other words, the same hegemon that establishes a relatively open market for goods will seek to establish closed market for intellectual property.

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[5] The theory of hegemonic stability was recently updated in Robert Gilpin, *The Political Economy of International Relations* (Princeton, N.J., Princeton University Press, 1987).

There is one important distinction to be drawn, however, between the hegemon's interests in goods and TRIPs. The hegemon's attention is most likely to be devoted to promoting open markets for its exports when it is "young" (i.e. when its economic dominance is newly achieved, and its competitiveness is unchallenged), but will turn its attention to protection of IPRs when it is comparatively "old" (i.e. when its relative economic strength has diminished, as its competitors have grown larger and more sophisticated). While the theory of hegemonic stability suggests that the hegemon will grow less supportive of open markets as its own competitiveness declines and as it progressively loses its share of both the domestic and export markets, there appears to be little evidence that support for intellectual property protection takes a similar plunge late in the hegemon's life. Quite to the contrary, better enforcement of IPRs offers twin advantages to a hegemon in its later years, as this suggests both defensive and regenerative responses to its own relative decline.

The product cycle discussed above tends to follow the course of the hegemon's economic dominance: the country is most competitive when its major industries are in the second and third phases (i.e. exportation and foreign investment), but begins to decline when the industries reach the fourth phase (i.e. the displacement of home-market production with imported goods). Stricter enforcement of intellectual property rights can play an important defensive role for the hegemon at this point, by seeking to decelerate (if not arrest) the pace of the product cycle. Mature industries will seek to use patent enforcement as a means of slowing the encroachment of competitors into their domestic and export markets.[6] IPRs might further also help the hegemon to re-establish its competitiveness. The country might attempt to restore its competitiveness through investment in knowledge- and capital-intensive industries, and thus initiate an entirely new product cycle for innovative goods. If successful, this national retooling effort could prolong or renew the hegemon's economic preeminence. This success could depend critically upon IPRs: the incentives for domestic industries to restructure and reinvest will be higher, if they can reasonably anticipate effective (albeit temporary) monopolies for any new products or processes that they develop. In the absence of such incentives, they might feel compelled to devote their capital towards acceleration of the product cycle for "old" innovations, i.e. moving still more of their production overseas.

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[6] In a somewhat more prosaic fashion, trademarks can also be used in a defensive strategy. Provided that the product in question is not a fungible good, a trademark - if it is respected by consumers and enforced by the legal system - can help a "mature" producer retain some of its market share.

The next question that arises is, how might the hegemon overcome any resistance that might be raised to its proposals for a stricter IPRs regime? The bargaining dynamics between these countries become more complex when the twin factors of economic growth and issue linkage are introduced. The preceding discussion suggested that the more advanced developing countries will be the leading source of concern for the hegemon, but they can also be expected to grow more supportive of IPRs as they become more economically advanced. The hegemon's aim is to ensure that the spread of IPRs enforcement at least keeps pace with the spread of technology, and preferably outstrips it. It must attempt to accomplish this task, however, at precisely the same time that its own economic strength has declined.

The most useful means that the hegemon might employ is to link trade with intellectual property rights. The hegemon can threaten to cut off the mid-level countries' access to its market, if they do not extend greater protection to intellectual property. This strategy is advantageous to the hegemon in two different respects:

- Firstly, it is intended to encourage a process that is alrealy underway in the mid-level countries, where the more competitive producers (i.e. innovators and exporters) may already be in favour of stricter IPRs laws. The continued industrialization of the mid-level countries will depend as much upon maintaining access to export markets as it will upon the acquisition of new technology (whether foreign or domestic), and the new threat to these export markets could tilt the internal balance towards the enactment and enforcement of stricter laws.

- Secondly, the hegemon has a comparative advantage in wielding this type of threat: due to the rising share of imports in its own market, the hegemon can put a significant share of the mid-level countries' trade at risk. In this sense, the hegemon's emerging economic weakness is a useful source of political leverage.

In brief, IPRs represent one important aspect of a much broader set of issues in the international economic system. The protection of intellectual property can be a contributing factor in determining the rate of innovation in new industries, the direction of trade, the destination of investment capital, and the relative growth of countries at different levels of industrialization. This admittedly simple model suggests that, all other things being equal, a relatively open regime (i.e. one in which intellectual property flows freely across borders) will tend to encourage growth in the emerging economies, at the expense of the hegemon and other industrially-sophisticated countries. Conversely, a stricter IPRs regime can serve to benefit the more advanced countries, but may do so at the expense of developing countries. The net global costs and benefits of the chosen regime depends on one's assumptions regarding the value of new technologies that might be encouraged through the establishment of a strict IPRs regime, and the extent to which such a regime might also permit abusive rent-seeking on the part of intellectual property owners.

2. The model applied to the Anglo-American experience

Both the British and American experiences demonstrate how the acceptance and enforcement of IPRs moves through successive stages, as a country matures economically. The policy path here is similar to the evolving position held on open markets, with England and the United States each having moved through periods of crude protectionism (accompanied by active pirating), early hegemony (with support for free trade), and late hegemony (with an increasing emphasis on IPRs). Not all countries can be expected to go through each of the stages described here - the phase of economic hegemony is clearly one that only a few countries can ever experience - but the process is nonetheless illustrative of progressive policy stages.

The modern patent system had its origins in English economic and juridical development, but originally emerged as a product of mercantilism rather than economic liberalism. England escaped its status as an economically backward nation during the Middle Ages in large measure because it practised a successful form of industrial piracy. Intellectual property in this period took the form of skilled labor, which was in short supply on the British Isles, and the Crown actively recruited European artisans. Skilled workmen were induced to migrate not only by the promise of sanctuary from religious wars on the continent, but also by the lucrative monopolies that England offered. They were given temporary patents (i.e. a monopoly in their respective trades), in exchange for the transfer of their knowledge and skills. At this time, no distinction was made between patents for new inventions, and other rent-seeking monopolies; a patent to produce some heretofore unknown item in England (e.g. mechanical clocks) was treated the same as a patent to monopolize a trade that entailed no new technology (e.g. the marketing of salt). The sale of patents was at this time a leading source of revenue for the Crown, and innovation was not a prerequisite for the extension of monopoly. Far from being the guarantor of intellectual property protection, patents ironically emerged as an efficient instrument of State-sponsored piracy.

The theory and practice of patents evolved considerably, however, as a result of English economic and political development. Opposition grew to the more repressive forms of monopoly (i.e. those not associated with technological innovations), and these became associated with the excesses of the Crown. With the rise of Parliament and the common-law courts, as well as the emergence of a more sophisticated and influential class of local innovators, English jurisprudence began to draw a tighter distinction between types of patents. The Statute of Monopolies (1624) was a great legal landmark in this process. It established the principle that the only legitimate monopolies were those granted to innovators, while those designed to enrich the monarchy and the monopolists were anathema. These distinctions were further developed through subsequent political, legal, and scholarly developments in the seventeenth century. In the words of one sympathetic scholar, this branch of the law transformed an instrument "from a master into a servant of the people," by replacing an abused royal prerogative with a positive incentive for creative minds.[7]

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[7] Harold G. Fox, *Monopolies and Patents: A Study of the History and Future of the Patent Monopoly* (Toronto, The University of Toronto Press, 1947), p. 4.

Copyrights also emerged in England as a decidedly illiberal practice. This instrument was originally a royal response to the printing press, which had greatly complicated the task of censorship. A royal edict therefore declared that books must obtain copyrights (i.e. a permit to print), before they could be mass produced. The concerns over censorship gradually diminished during the seventeenth century, and copyrights became instead a useful means for the printing guilds to enforce their monopoly. This restriction on competition also fell victim to anti-monopolistic reforms, when Parliament eliminated special guild privileges in 1695. This was followed by the Statute of Anne (1709), which transformed copyrights from the right of printers to restrict competition, to the right of authors to control the sale of their own works.

England's economic growth during the eighteenth century eventually gave way in the nineteenth century to a position of hegemony. The country's substantial competitive edge over European manufacturers was attributed in no small measure to its superior technology, and English political economists and policymakers recognized the importance of restricting the flow of intellectual property to potential competitors in Europe and North America. Enforcement of IPRs at home could not be readily separated from the need to retard industrial development abroad. British policy on this matter did not differ fundamentally from traditional mercantilism, which was based as much upon export restrictions for the means of production (specie, raw materials, skilled workmen, etc.), as it was on import restrictions for manufactured goods. Even such ostensibly liberal scholars as Robert Torrens, Naussau Senior, and other advocates of free trade called for strict bans on the export of capital goods and related technologies.[8]

England was never as successful in forging a global IPRs regime as it was in promoting open markets for goods. The country supported the establishment of several international agreements during the late nineteenth and early twentieth centuries, such as the Paris and Berne conventions, but these instruments generally lacked sanctions and enforcement provisions. In the absence of a formal IPRs regime, with adequate powers of enforcement (e.g. via linkage to trade), England was not very successful in slowing the spread of intellectual property. Many important British innovations made their way across the Channel and the Atlantic, contributing to the growth of foreign competitors and the relative decline of British industry. Some economic historians attribute England's gradual loss of hegemony to a combination of technology transfer, coupled with failure to develop new technologies.[9] These were economic and institutional lessons that United States policymakers would later take into account, during their own period of late hegemony.

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[8] See Bernard Semmel, *The Rise of Free Trade Imperialism: Classical Political Economy, the Empire of Free Trade and Imperialism, 1750-1850* (Cambridge, Cambridge University Press, 1970), especially pp. 181-84. See also Karl Polanyi, *The Great Transformation* (New York, Farrar and Rinehart, 1944), p. 136.

The economic history of the United States demonstrates a similar gravitation towards the liberal intellectual property position, albeit along a somewhat different route. The founders of the republic adopted some of the English legal and economic heritage, writing into the Constitution a provision declaring that Congress may "promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive rights to their respective writings and discoveries". This statement of IPRs liberalism was somewhat premature, however; although the United States did extend patent and copyright protection from the very start of its existence, it was still in the technology-importing stage of its economic development. This was perhaps best expressed by the first Secretary of the Treasury, Alexander Hamilton, whose famous *Report on Manufactures* (1791) anticipated the principles of industrial targeting. In addition to establishing the doctrine of infant industries (i.e. the policy of extending trade protection to nascent manufacturers), and providing direct government support for research and development, Hamilton's report urged that - like England in previous centuries - the United States should acquire technology by encouraging foreign artisans and inventors to immigrate.[10] The United States did indeed benefit in its first several decades from an unofficial policy of technology transfer. American businessmen attempted to bypass British controls on technology, by illicitly importing state-of-the-art intellectual property.

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[9] W. Arthur Lewis, *Growth and Fluctuations, 1870-1913* (London, George Allen and Unwin, 1978).

[10] See the concluding section of Alexander Hamilton, "Report on the Subject of Manufactures" (1791), in A.H. Cole, ed., *Industrial and Commercial Correspondence of Alexander Hamilton, Anticipating His Report on Manufacturing* (Chicago, A.W. Shaw, 1928).

It was only after the nation grew in economic and political stature, and developed an important indigenous industrial base and a local class of successful innovators, that its practices came closer to the liberal paradigm. The country was somewhat slow, however, in extending this protection to non-American innovators. The United States joined the Paris Convention for the Protection of Industrial Property in 1887, but did not formally join the Berne Convention for the Protection of Literary and Artistic Works until 1988. The United States did not provide copyright protection to foreign works and authors until 1891, and it was not until 1986 that the country offered copyright protection to most English-language books that were written by United States residents and printed abroad.

By the time that America emerged as the new hegemon in the Second World War, its credentials as a technological leader - and hence its dependence upon the protection of IPRs - were firmly established. The United States therefore followed Britain in seeking to stem the flow of intellectual property abroad, but at a different pace and through different means. The country made less effort in its early hegemony to block the transfer of technology overseas. While the country attempted to enforce its monopoly or near-monopoly in a few strategic areas, especially in nuclear weapons and militarily-critical technologies, the United States generally allowed other technologies to migrate (provided that the transfer was not to the Soviet Union or its allies, and was done voluntarily by American corporations). The crux of United States IPRs policy in the post-war period has been to ensure that foreign countries adopt and enforce laws that conform generally to the Anglo-American model, by providing exclusive rights to authors and inventors for limited periods, respecting trademarks, not imposing mandatory transfers of technology, and prohibiting counterfeit goods. The nation's principal objective in the global IPRs regime is therefore not to deny non-military technology to its competitors, but rather to set the terms upon which this technology may be employed, and demand punishment when those terms are violated.

These objectives did not receive much attention from American policymakers until the late 1970s. As the model discussed earlier suggests, it was at this stage in its hegemony that the United States began to take a more defensive posture in the international trade regime, and viewed stricter IPRs enforcement as one means of improving its declining trade balance and preventing the further erosion of its competitive edge. The first United States attempt to introduce TRIPs to multilateral trade talks came late in the Tokyo Round, when United States negotiators sought approval for a GATT anti-counterfeiting code. This attempt failed, but the United States eventually succeeded in placing the TRIPs issue on the table in GATT.

These international initiatives were accompanied by a renewed interest in the scope of domestic intellectual property laws. Beginning in the late 1970s, the United States began revising its statutes and regulatory practices to ensure that patent and copyright protection was extended to new innovations, such as biotechnology, semiconductor mask works, computer software, and even certain mathematical equations. These domestic initiatives, in turn, led to demands that United States trading partners enact and enforce similar laws. It is these demands, and the controversies surrounding them, that are at the center of the contemporary TRIPs dispute.

It is worth noting that the British and American experiences have subsequently been repeated, with some variations on the theme, in the other major industrialized countries. Japan in particular can be pointed to as an example of the reformed imitator-turned-innovator. Japanese "borrowing" of technology was a major irritant for United States corporations in the early and middle post-war periods, when charges of patent and trademark infringement were frequent, but Japanese companies have subsequently developed their own technological base. Japanese companies now account for a major share of the patents now granted to foreigners, and in 1986 no fewer than 18.6 per cent of all patents went to Japanese inventors. This is not to say that United States-Japanese relations on TRIPs are entirely harmonious - American innovators and patents administrators complain that it is difficult for foreigners to obtain patents in the Japanese system, and there are still many complaints from United States companies over alleged Japanese counterfeiting and technology piracy - but Japan has nonetheless adopted an intellectual property regime that is much more like that of the United States, than that of an industrially unsophisticated country.

Japan generally supports the United States initiative for a stricter global IPRs regime, with certain differences over the terms of this regime, as do other industrialized countries.

3. The model applied to developing countries

As the previous analysis suggests, the proposal to establish a stricter international IPRs regime is of great importance to developing countries. Whether one accepts the United States view that intellectual property protection is ultimately in the interests of all countries (due to the salutary effect it has on new innovations), or adopts the more sceptical views of those who criticize the United States policy, it is clear that this is one of the most divisive issues in North-South economic relations.

The most critical arena in the international TRIPs debate will naturally involve the hegemon and the more economically advanced developing countries. This latter group of countries, which we will refer to generically as newly-industrialized economies (NIEs), presents an increasingly important economic challenge to the hegemon. They hold a status between the other industrialized countries (with whom the hegemon will not ordinarily have severe TRIPs disagreements, due to their generally liberal intellectual property regimes), and less developed countries (that are either not large enough or sufficiently industrialized to pose an appreciable challenge to the hegemon). The product-cycle theory outlined above suggests that the technological bases of the NIEs will advance, their industries will grow more competitive, and their exports will rise, while the hegemon undergoes a relative erosion in its technological, competitive, and trade advantages. This advancement of the NIEs may be attributed in some measure to their adoption of foreign technology, which may (in the eyes of the hegemon) involve intellectual property violations. It is therefore in the interests of the hegemonic country to take action to arrest its own relative decline, by seeking to convince the NIEs to adopt intellectual property regimes that more closely approximate its own.

If the intellectual property issue were one of fixed interests, in which the interests of individual countries were invariable, one would expect that the hegemon would be entirely unsuccessful in this venture. There are two critical factors, however, that must be taken into account: the evolving interests of the developing countries, and the leverage used by the hegemon. The first factor affects the NIEs' own definition of their economic interests. As was suggested by the model, the economic advancement of the NIEs will ordinarily lead to greater internal pressures for the adoption of stricter intellectual property laws. To the extent that industries within these countries develop more advanced stages of intellectual property, they can be expected to support domestic laws that permit them to control this property. They might also begin to view international intellectual property protection as a means of preserving their own emerging status as exporters of manufactured products. If other developing countries are permitted to adopt these same technologies, then the further economic advancement of the NIEs may be threatened.

These internal changes could take many years to translate themselves into new intellectual property policies. This is where the second critical factor - the hegemon's policies - can come into play. The hegemon could attempt to hurry this process along, by linking the NIEs' treatment of its intellectual property to its own treatment of the NIEs' exports. The hegemon can thus attempt to alter the benefits and costs that the NIEs perceive in intellectual property protection, in order to hasten the day that they adopt policies consistent with its own economic interests. This thesis is explored further in the next section.

B. Intellectual property issues in contemporary United States policy

The preceding section presented a model of intellectual property, in order to explain the economic interests of the United States and its trading partners in this issue. This section explores the topic in more concrete terms, by examining the broad thrust of United States policy. The issues discussed here will then be examined in greater detail in the remainder of the paper.

Several recent studies have supported the claim that intellectual property violations are costly for the United States, and that developing countries are the principal sources of these losses. The United States

International Trade Commission estimated that in 1986 alone, IPRs violations cost American industries $23.8 billion in lost domestic sales, exports, and royalties.[11] These figures were further broken down by industry and country, with the Commission estimating that the larger and more advanced developing economies were principally responsible. If these figures are accurate, they suggest that intellectual property losses were equivalent that year to about 14 per cent of the merchandise trade deficit, and about 1.5 per cent of the country's gross national product. The ultimate costs of a lax intellectual property regime may be even greater, if it contributes to the relative economic decline of the United States, and complicates the United States efforts to reinvigorate its industries.

It is therefore not surprising that the United States hopes to persuade developing countries (and especially the NIEs) to enact and enforce stricter intellectual property laws, and to accept the legitimacy of multilateral discipline in this area. In the long term, one might conclude from the preceding discussion that this goal can be attained without any policy intervention: one need only wait until the developing countries reach an appropriately advanced stage of development, spurred along in part by imported technology, at which time they will voluntarily take the desired steps. This advice may not be happily received by American statesmen, however, who must measure progress in years rather than generations. The task of United States negotiators is to convince their counterparts in the developing countries to accelarate the pace of policy changes, and to adopt the liberal IPRs position at an early date. Conversely, many developing countries hope to forestall the day when they conform their policies to the expectations of the more advanced countries, at least until that point where the perceived national benefits of changing their policies exceed the perceived national costs. The TRIPs issue therefore presents difficult negotiating problems for the United States and the developing countries.

The only means that United States negotiators have of accomplishing this end are (1) to persuade developing countries to re-evaluate their *perceptions* of the costs and benefits involved (i.e. convince them that the liberal economic theory of intellectual property is correct), or (2) to take action that *materially* alters these costs and benefits. In other words, if developing countries cannot be convinced that a stricter IPRs regime is in their own best interests, then it may be necessary to link this issue to some other matter of interest to them. The linkage could be either positive or negative. On the positive side, the American negotiators might promise better access to the United States market, in exchange for concessions on TRIPs. This is one of the "grand strategies" underlying the Uruguay Round of multilateral trade negotiations. On the negative side, United States negotiators might threaten to reduce the access that developing countries now enjoy to the United States market, if they do not make concessions on TRIPs. This is the basis for the "reciprocity" strategy now being pursued by the United States. In this mix of positive and negative inducements, the United States hopes to attain multilateral and or bilateral agreements that will safeguard its present and future intellectual property.

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[11] United States International Trade Commission, *Foreign Protection of Intellectual Property Rights and the Effect on U.S. Industry and Trade*, USITC Publication 2065 (Washington, D.C., USITC, 1988).

The Uruguay Round represents the positive side of the equation. One of the leading American objectives in these talks is to achieve a comprehensive agreement on TRIPs, which would ultimately be superior to pursuing episodic disputes in isolated, country-specific cases. As formally presented in 1987, the United States goal is to make IPRs protection an integral element in the international trading system, and to legitimize the linkage between this topic and trade in goods.[12] The centerpiece is a proposed multilateral agreement that would require that all signatories agree *inter alia* to "create an effective economic deterrent to international trade" in goods and services that violate IPRs, "recognize and implement standards and norms that . . . provide a basis for the effective enforcement of such rights, and "extend international notification, consultation, surveillance and dispute settlement procedures to protection" of IPRs. In effect, the agreement would oblige other GATT members to protect American intellectual property, define the terms under which this protection must be extended, and ratify the United States policy of threatening retaliation against countries that violate these rights. The implicit bargain offered by the United States is that, in exchange for a commitment on this and other issues (especially services, investment, and agriculture), the United States will further reduce its trade barriers, and may agree to refrain from taking unilateral action against its trading partners.

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[12] It is important to note that in bringing its concerns to the GATT, the United States enjoys an advantage that Britain did not have in its own period of declining hegemony. Whereas British trade policy did not have the benefit of a formalized global trading regime, and was not formally connected with TRIPs, the United States hopes to link the two issues together. The United States can thus attempt to use the trade institution that it helped to establish in its early hegemony, to achieve an important goal in its late hegemony.

This proposed bargain is fairly easily understood, if not so easily struck; it is the negative side of the equation that requires greater explanation. The United States threatens to employ various coercive instruments at the bilateral level, if it is prevented from achieving its goals at the multilateral level. There are two principal instruments that United States negotiators have at their disposal, when pursuing this option: the retaliation authorities extended under Section 301 and related provisions of the Trade Act of 1974 (as amended), and conditionality in the Generalized System of Preferences (GSP) and the Caribbean Basin Initiative (CBI). In each instance, the United States attempts to establish linkage between a country's IPRs policies and its access to the United States market, but the retaliatory statutes and the preferential trade programmes link the issues in somewhat different ways. They can be distinguished by their scale, intensity, and procedures.

II. INTELLECTUAL PROPERTY LAWS

The preceding section of this paper examined the political economy and the internal politics of United States policy on IPRs, in order to explain what the United States is seeking in this area. The purpose of this section is to assess the instruments that the United States has at its disposal to achieve these goals. The statutory mechanisms in United States intellectual property law range from purely domestic laws intended to enforce the intellectual property regime, to confrontational reciprocity laws that can be used to pressure developing countries into meeting United States demands.

Many of the statutory provisions discussed in the pages that follow are the products of two major legislative initiatives undertaken during the Reagan administration. The Trade and Tariff Act of 1984 and the Omnibus Trade and Competitiveness Act of 1988 contained numerous provisions relating to IPRs, and they jointly helped to make the issue a top priority for United States trade negotiators. In addition to establishing the United States negotiating objectives for TRIPs, these two laws created several new mechanisms that United States negotiators may use to win concessions in bilateral negotiations. Perhaps the most important of these is the new "Special 301" provision of the 1988 law, which is being used to threaten developing countries with commercial retaliation, if they do not alter their intellectual property laws. Other provisions in the laws permit the initiation of retaliatory cases when United States firms or interest groups submit petitions, and the linkage between IPRs and trade preference.

While each of these laws can be examined as a discrete statutory mechanism, it is important to recall that they collectively compose a menu of options for United States interest groups and policymakers. The question that these actors face is often not *whether* to purpose changes in a trading partner's IPRs regime, but precisely *which* instrument would be best suited to achieves this objective. As illustrated in box 1, the available options can be divided between those based upon unilateral enforcement, either within the domestic market or at the border, and those requiring negotiations with other countries. The policies "above the line" include domestic patent laws and regulatory procedures, restrictions on the export of certain strategic technologies, and enforcement measures that restrict imports. The options "below the line" are aimed at convincing United States trading partners to accept changes in domestic and transnational IPRs regimes, in order to make them more favourable to American economic interests. Unlike those options that accomplish their ends simply through enforcement, these approaches are effective only to the extent that they persuade or pressurize another country into altering its own policies and practices. These negotiating options often entail rational arguments intended to persuade foreign negotiators that liberal IPRs policies are in their best interests, insofar as they make foreign investment more attractive for local innovators. For reasons that were explored in section I, persuasion may prove effective in some instances, but there is little reason to expect that a developing country will adopt liberal IPRs policies any earlier then is demanded by its own internal economic evolution (i.e. prior to the point at which innovators outweigh imitators in the domestic political economy). The object for American trade diplomacy, therefore, is to intervene in order to alter the costs and benefits that a developing country perceives in the TRIPs issue.

A. Unilateral measures

The unilateral measures are in certain respects the most simple and straightforward aspects of the United States IPRs regime. They permit owners of intellectual property rights to bring action before either the United States International Trade Commission (USITC) or the courts, in order to halt sales of products that are alleged to infringe upon their property rights. The chief distinctions between these laws are the point of enforcement: the Section 337 statute is designed to exclude IPRs-violating products at the border, while the other laws are intended to provide redress for products that have entered the domestic stream of commerce.

1. Unfair trade practices law (Section 337)

Section 337 of the Tariff Act of 1930 (as amended) is commonly referred to as the "unfair trade practices" section of United States commercial law. It is intended to provide legal redress from all manner of unfair import practices, ranging from breach of contract to false advertising and misrepresentation of a product's source, but in actual practice nearly all cases brought under this statute concern allegations of IPRs violations. The statute has until recently held a relatively "low profile" in the array of United States trade-remedy laws, especially when compared to the Section 301 retaliatory law and the anti-dumping and countervailing duty laws, but it may become a more controversial element in IPRs policy. It is now under greater scrutiny, as a result of a recent GATT panel ruling that questioned the GATT-legality of the law, and amendments made to it in 1988.

The statute provides a legal remedy for alleged violations of patents, trademarks, and copyrights, by permitting intellectual property owners to petition the USITC for relief. The law specifies that if the

Commission determines that an imported product does in fact violate a valid patent of an industry that either exists in the United States, or is in the process of being established, then it may issue "cease and desist orders" (i.e. order to the foreign firm to discontinue the practice), or "exclusion order" (i.e. orders to the United States Customs Service to bar entry of the imports). Once an import has been excluded under this law, the exclusion order remains in place as long as the patent, trademark, or copyright is valid.

There were 295 petitions filed under Section 337 between 1972 and early 1989, 49 of which resulted in exclusion orders that were still in place as of March 1989. Thirty-five of these outstanding orders involved allegations of patent infringement. Three Asian NIEs and Japan collectively accounted for a disproportionate share of the outstanding orders. Most of the orders affect relatively unsophisticated items (e.g. dolls, cast-iron stoves, and plastic food-storage containers), but a few are directed against high-technology goods (e.g. dynamic random access memories imported from Japan).

The 1988 trade law amended Section 337 in several ways. The most important alteration is a vast reduction in the injury standards that apply in these cases. Prior to the amendment, the law required that a petitioner prove to the USITC not only that the imports in question do constitute IPRs violations, but also that (a) the petitioner is injured by these practices, and (b) it is efficiently and economically operated. These latter two findings were the rough equivalents of the "injury tests" applied in anti-dumping and countervailing duty cases. As amended in 1988, Section 337 now requires that the petitioner merely demonstrate that the United States industry exists, or is in the process of being established, within the United States. The petitioner need not prove that it is "efficiently and economically operated", or injured by the alleged violation. These changes will facilitate rulings in favour of petitioners, by reducing the findings of fact that they must establish. The new law also increased the penalties for non-compliance with cease-and-desist orders (raising maximum fines from $10,000 per day, to $100,000 per day), allowed for default findings in the petitioner's favour if the respondents do not appear before the USITC, and authorized the USITC to order the seizure and forfeiture of imported articles. In brief, these amendments both increase the likelihood that a petitioner will win its case, and heighten the possible penalties.

Even more controversial than the 1988 amendments is a recent report made by a GATT dispute-settlement panel. The European Community challenged the Section 337 statute on behalf of a Dutch firm in 1985, after the USITC concluded that the firm's aramid fibre products infringed on a United States patent, and issued an exclusion order against the imports. The panel investigating the complaint found the United States law inconsistent with the General Agreement, in that it treats foreign companies less favourably than United States companies in patent cases. When one United States company accuses another of patent infringment, the case will be considered in a formal court of law, in which the accused enjoys various legal and procedural protections. By contrast, the Section 337 law applies exclusively to imported products, and requires that the case be decided within the statutory deadlines and procedural restrictions of the USITC.[13]

This unfavourable panel report comes at a rather embarassing moment for United States negotiators, given their twin emphases on the importance of a strict intellectual property regime, and the need to respect GATT dispute-settlement procedures. The panel report appears to require that the United States change the Section 337 statute in key respects, a requirement that might be viewed in the Congress as a retreat from strict IPRs enforcement. Some in Washington have suggested that the issue could provide room for manoeuver within the Uruguay Round negotiations. For example, one spokesman for a United States intellectual property coalition recently suggested in congressional testimony that changes in Section 337 be considered part of a comprehensive GATT package on TRIPs.[14] In other words, the United States obligation to change its laws would be treated instead as a concession, in partial exchange for concessions from other countries. The Bush administration has not yet announced whether, in what manner, or on what conditions it might seek legislative revision of the statute, although one USTR official stated publicly that Section 337 should not be sacrificed for other objectives.[15] Some officials in the executive branch apparently are concerned that the statute is too popular in Congress for them to ask for unilateral United States changes.

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[13] GATT, *United States - Section 337 of the Tariff Act of 1930*, L 6439 (16 January 1989).

[14] Testimony of the Intellectual Property Committee before the Senate Finance Committee (20 April 1989).

2. Extraterritoriality for patents

The United States patent regime gives intellectual property owners an additional legal remedy, when they allege that imported products violate their patent rights. If they are unable to halt imports at the border, through petitions under Section 337 (see above), they can attempt to halt sales within the stream of domestic commerce. This can be accomplished by suing importers or retailers that sell the infringing products. In effect, these lawsuits permit an element of extraterritoriality for United States intellectual property rights. Owners of intellectual property rights can use these laws as an indirect import barrier, by following the doctrine that "no one wishes to buy anything if with it he must buy a lawsuit".[16] In other words, potential United States importers of a foreign good might be dissuaded from purchasing the product, if they suspect that this purchase could subject them to legal liability.

The reach of these laws has recently been extended. Prior to enactment of the Process Patent Amendments Act of 1988 (which was incorporated in the 1988 trade bill), this avenue was open only to patent owners; holders of process patents could not bring similar suits. This restriction was of particular concern to the pharmaceutical industry, which is highly dependent on process patents. The 1988 law permitted process patent owners the same rights to sue as other patent owners. The amendments also established a rebuttable presumption on the part of the court that there has been a violation of the process patent, if the court finds that there is a substantial likelihood that the product was made in violation of the process patent, and finds that the claimant has made a reasonable effort to determine that the patented process was in fact used. These provisions establish a formidable defence for holders of process patents, and could act as a subtle barrier to some imports. (It is worth noting, however, that no actual suits have been filed in the first eight months since the enactment of the amendment).

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[15] *International Trade Reporter*, Vol. 6, No. 17 (26 April 1989), p. 528.

[16] Supreme Court of the United States, *Kessler v. Eldred*, 206 U.S. 1065, 1068 (1907).

B. Bilateral measures

1. Coercive bilateralism (Section 301, Super 301, and Special 301)

The USTR has three principal instruments at its disposal for coercive negotiations on TRIPs: the original Section 301 retaliatory statute, a so-called "Super 301" provision designed to govern comprehensive trade negotiations with selected countries, and a "Special 301" mechanism that could lead to new confrontations on TRIPs.[17] The first of these provisions was initially enacted as part of the Trade Act of 1974, and was subsequently revised in 1984 and 1988; these revisions clarified *inter alia* its use as an instrument in TRIPs negotiations. The latter two mechanisms were created by the Omnibus Trade and Competitiveness Act of 1988. We will first examine Section 301 and its application to TRIPs, and then turn to the new provisions.

Section 301 of the Trade Act of 1974, as amended, provides United States trade authorities with a potent weapon for retaliatory policies. This statute allows the USTR to threaten trading partners with retaliatory sanctions, if they do not alter or eliminate trade policies that are judged to violate United States rights. Although Section 301 is often characterized as a trade-remedy law, similar to the anti-dumping and countervailing duty statutes, it is more accurately portrayed as a coercive and one-sided form of negotiating authority. The statute gives the USTR the power to take all "appropriate action" to obtain the removal of foreign-trade barriers that are deemed to violate United States trade rights, including the threat and actual imposition of retaliatory tariffs and quotas. Unlike the multilateral and bilateral authorities discussed elsewhere in this paper, which are based upon the exchange of mutually-beneficial concessions between the United States and its trading partners, Section 301 places the entire burden of adjustment upon the United States trading partners. It revolves around direct negotiations between United States Government officials and their foreign counterparts, rather than the more formal, quasi-judicial proceedings that are characteristic of the anti-dumping and countervailing duty laws.

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[17] Note that the terms Super 301 and Special 301 are not actually used in the law, but rather have been adopted as the common names identifying these new statutory mechanisms. They are more formally cited as Sections 1302 and 1303 of the Omnibus Trade and Competitiveness Act of 1988, which respectively (and retroactively) create new Sections 310 and 182 of the Trade Act of 1974.

In contrast to the trade-remedy laws, which focus upon allegedly unfair foreign exports into the United States market, most Section 301 cases are concerned with the treatment accorded to United States property - including intellectual property - in foreign markets. The objective in a case may be to convince the foreign government to fulfil an obligation it has under an existing trade agreement, or to make a new concession to the United States, such as alteration of its intellectual property laws. The retaliatory option is the *means*, rather than the *objective*, of the petitioning industry and the United States negotiators. The goal is to use the threat of retaliation as a means of obtaining concessions, without actually having to resort to sanctions. The statute cannot therefore be characterized as a simple "protectionist" mechanism, despite the fact that its use might entail restrictions on imports into the United States market.

Prior to the mid-1980s, the statute was not used in cases involving TRIPs. After the Trade and Tariff Act of 1984 expanded its scope to cover intellectual property violations, and the Reagan administration adopted a more aggressive approach to trade policy in 1985, this statute became a key element in United States IPRs policy. The USTR self-initiated two Section 301 cases on IPRs in 1985, and has subsequently pursued two other intellectual property cases that were requested by the Pharmaceutical Manufacturers Association (PMA). One of the PMA cases recently led to a GATT complaint by Brazil, in which the sanctions imposed by the United States were alleged to have violated Brazil's trade rights.

While the Section 301 mechanism will continue to be used in disputes between the United States and its trading partners, the Super 301 provision is likely to be the more prominent instrument in 1989 and 1990. It is not certain, however, whether Super 301 will be applied against IPRs problems; the Special 301 provision is more directly concerned with these issues. Super 301 requires that the USTR name in 1989 and 1990 the "priority" unfair trade practices of other countries, and initiate Section 301 cases against them. The first step in this identification was made on 24 March 1989, when 37 United States firms and interest groups submitted petitions to the USTR, indicating their complaints against foreign countries; three of the petitions cited concerns over IPRs. The USTR then released at the end of April its annual National Trade Estimate report.[18] This document listed the allegedly unfair trade practices of 34 United States trading partners, including 19 developing economies. These allegations of unfair trade practices included IPRs violations (see box 2). The next step was taken in May, when the USTR further narrowed the list down to those countries and practices that are considered to be priorities. The three countries chosen by the USTR - Brazil, India, and Japan - were not cited on the basis of TRIPs issues. If the countries against which these cases are initiated do not agree within 12-18 months either to (a) eliminate or provide compensation for the practice within three years, or (b) reduce the practice over a three-year period, then the USTR may retaliate against the country.

It is the Special 301 provision, however, that is most likely to multiply the IPRs disputes between the United States and developing countries. This section of the 1988 trade law amended the Trade Act of 1974, to create a special procedure for USTR identification of countries that are alleged to provide inadequate IPRs protection, and self-initiation of Section 301 cases against them. It requires that the USTR annually identify those countries that deny adequate and effective intellectual property protection, and deny market access to United States producers that rely upon intellectual property protection. Furthermore, the USTR must indicate which of these are "priority foreign countries," for purposes of the statute. This finding will be based upon the USTR's annual trade barriers report, the petitions it receives from firms and industry groups, and consultations with other officials in the United States Government (e.g. the Commissioner of Patents and Trademarks).

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[18] Office of the United States Trade Representative, *1989 National Trade Estimate Report on Foreign Trade Barriers* (Washington, D.C., United States Government Printing Office, 1989).

The law specifies that a foreign country will be considered to deny protection of intellectual property rights if it "denies adequate and effective means under the laws of the foreign country for persons who are not citizens or nationals of such foreign country to secure, exercise, and enforce rights relating to patents, process patents, registered trademarks, copyrights and mask works". Furthermore, a foreign country is considered to deny fair and equitable market access if it

> effectively denies access to a market for a product protected by a copyright, patent, or process patent through the use of laws, procedures, practices, or regulations which (a) violate provisions of international law or international agreements to which both the United States and the foreign country are parties, or (b) constitute discriminatory nontariff trade barriers.

A separate provision of the 1988 trade law gave "teeth" to the Special 301 mechanism, by directing the USTR to self-initiate Section 301 cases against the priority countries. It stated that the USTR must begin a Section 301 investigation against any priority country within 30 days of its having been so identified. The USTR does have some discretion, however, as the statute specifies that the agency need not initiate such a case if it "determines that the initiation of the investigation would be detrimental to United States economic interests". Any such case that is self-initiated will ordinarily require resolution within two years, depending on the progress of the talks and the steps that are taken; this schedule implies that the cases will be adjudicated concurrently with the final stage of the Uruguay Round negotiations on TRIPs. These overlapping schedules invite the USTR to use the Special 301 process, either implicitly or explicitly, as a means of leverage within the Uruguay Round talks.

The provision could apply to many areas of economic policy, ranging from IPRs enforcement *per se* to investment regimes and market-access restrictions. A congressional report on the new law gave examples of foreign barriers that might come under this provision, citing *inter alia* "the establishment of licensing procedures which restrict the free movement of such products", "denial of an opportunity to open a business office in a foreign country", and "non-tariff barriers such as expropriatory policies of a foreign government which disestablish United States investments related to products protected by intellectual property rights through their forced resale to private parties in the foreign country". Perhaps even more consequential was the report's statement that the Congress "is particularly concerned about those trading partners who erect barriers to trade in products protected by intellectual property rights on the grounds of protecting cultural sovereignty". According to the report,

> Such restrictive practices often have a direct and significant adverse financial impact on United States industries. Furthermore, such practices may be imitated by other trading partners around the world on the same pretext, thus having the potential to damage seriously important sectors of the U.S. economy.[19]

This note was intended to urge the USTR to use the statute as a means of addressing concerns expressed by the entertainment and publishing industries, and most especially motion pictures.

The USTR further interpreted the Special 301 procedures, in a manner that elongates the potential time-frame for implementation. The agency's execution of the law began in early 1989, when it formally requested that any interested parties submit information on foreign countries that violate United States intellectual property rights. The agency received a total of 12 submissions by the 9 February 1989 deadline, in which complaints were made against 18 United States trading partners, 13 of which were developing economies. Perhaps more important was the USTR's release of the National Trade Estimate report on 28 April 1989 which listed (but did not yet prioritize) the United States complaints with the trade regimes of nineteen developing economies. It is notable that the USTR's report found fault with the TRIPs policies of every one of these nineteen trading partners. All of these countries, territories, and groups were potentially liable for identification by the USTR as IPRs violators.

Rather than issue a definitive list of target countries at the end of May, as had been implied by the 1988 statute, the USTR decided instead to issue a "watch list" of 25 trading partners that are under consideration for such action. Included on this list were eight "priority" trading partners, which are under more active review than the remaining

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[19] United States Congress, House of Representatives, *Omnibus Trade and Competitiveness Act of 1988: Conference Report to Accompany H.R.3*, Report 100-576 (Washington, D.C., U.S. Government Printing Office, 1988), p. 581.

17. The USTR stated that it will determine by 1 November 1989, whether any action is warranted against these priority countries, such as initiation of Section 301 retaliatory cases; the other countries are also subject to possible action, but the threat is less immediate. The innovation of the watch list was apparently intended to give the USTR more time to use pressure without resorting to the actual initiation of formal procedures. On 1 November 1989, the USTR decided to move the Republic of Korea, Saudi Arabia and Taiwan from the priority list to the non-priority section of the watch list.

2. Linking trade preferences to TRIPs

Section 301 and related mechanisms are extremely high-profile instruments of economic diplomacy, and they have heretofore been used almost exclusively against industrialized countries and NIEs. The less developed countries have not thus far been targeted under these statutes, in part because there are other, less dramatic statutory authorities that can be directed toward these countries. Chief among them is conditionality in preferential trade programmes.

Most developing countries are granted some degree of preferential access to the United States market, through the Generalized System of Preferences (GSP) and or the Caribbean Basin Initiative (CBI). Both of these programmes were originally intended to provide a sort of free-market form of foreign assistance, by offering non-reciprocal, duty-free treatment for certain qualifying products that the beneficiary countries export. In recent years, however, these programmes have been used as indirect tools by American trade negotiators. Beneficiary countries may find their privileges under these programmes increasingly conditional upon meeting United States trade demands on TRIPs and other issues. In effect, this conditionality is the functional equivalent of Section 301, but is generally directed at smaller and less industrially sophisticated countries.

The GSP has contained neoreciprocal elements ever since it was renewed by the Trade and Tariff Act of 1984. That law stated that beneficiary countries could lose GSP privileges, if they did not meet certain United States requirements. Among these requirements was the protection of intellectual property. TRIPs and other so-called "country practices" issues could be raised in a general review of the GSP programme, as well as in annual reviews, where the United States would examine each beneficiary country's level of economic competitiveness and its trade regime. The law further provided that the USTR could threaten countries with the partial loss of GSP privileges on some products, or offer them more secure GSP benefits on others, depending on whether or not the country co-operated with the United States. In effect, these reviews gave United States firms and interest groups an opportunity to challenge the intellectual property policies of GSP countries, while the associated negotiating mechanisms gave the USTR the ability to use trade preferences as leverage in consultations with the foreign governments.

The USTR conducted the general review in 1985-87. The review began with a petitioning process, in which dozens of United States firms and groups made formal complaints against the policies and practices of various beneficiary countries. Groups ranging from the American Electronics Association to the International Anticounterfeiting Coalition submitted petitions citing problems with IPRs, and collectively alleged that no fewer than 39 developing countries, territories, and trading associations violate United States patents, trademarks, or copyrights. Following receipt of these petitions, and a series of public hearings, the USTR held consultations with several developing countries. Many of these GSP beneficiaries were faced with a choice of altering their IPRs laws and policies, or losing GSP eligibility for certain products.

The review concluded on 2 January 1987, when the USTR announced that several of the more advanced beneficiary countries were losing part of their GSP eligibility, while some other countries were being rewarded with more secure access under this programme. In making the announcement, the USTR noted that the general review helped to secure improved protection for United States intellectual property in seven countries and territories in Asia and the Pacific.

TRIPs issues have also been raised in the subsequent annual GSP reviews, but with mixed results. The International Intellectual Property Alliance requested in a 1986 petition that the USTR deny GSP benefits to Indonesia, as a result of that country's alleged failure to provide adequate and effective protection for copyrights. The USTR accepted this petition for review, and held consultations with the Government of Indonesia. The petition was later dismissed in the 1987 GSP review. The dispute was ultimately resolved in 1989, when the USTR signed an agreement with Indonesia, in which the country agreed to protect copyrights on books, sound recordings, films, computer software, and other creative works. The second TRIPs complaint came in 1987, when the Pharmaceutical Manufacturers Association alleged that Thailand does not protect product and process patents for pharmaceuticals. The USTR and the Government of Thailand were unable to come to an agreement on this issue, and the USTR announced in early 1989 that Thailand's GSP benefits would be cut. Thailand lost GSP eligibility for some products, and was denied more secure GSP benefits on others, with the total sanctions, being valued at between $60 and $200 million in trade (depending on one's assumptions regarding future import trends).

The USTR may use future GSP annual reviews as a means of bringing pressure on developing countries that are alleged to violate IPRs. The programme remains an important form of leverage in United States trade negotiations. This fact is demonstrated by the magnitude of trade involved: $50.0 billion worth of United States imports from developing countries were eligible for GSP treatment in 1988. The utility of this leverage varies across countries, however. As shown in table 1, GSP benefits account for a relatively small share of some countries' exports to the United States, but represent a considerable share of other countries' shipments.

The CBI is similar in many respects to the GSP, and could be equally useful to United States negotiators as a means of pressuring the beneficiary countries. The CBI is a one-way free trade area, by which the United States extends duty-free import privileges to most products exported by selected Central American and Caribbean trading partners. The programme offers certain advantages over the GSP, such as broader product coverage, and no "competitive need" restrictions on the level of benefits that a country can receive for a given product. Benefits under this programme have been tied to TRIPs, however, since its very inception. When the initiative was first proposed to the Congress by President Reagan in 1982, several IPRs-related interest groups seized upon the proposal as a means of winning leverage over the programme's intended beneficiaries. They succeeded in convincing the Congress to amend the CBI legislation, so as to make a country's benefits under the programme conditional upon its IPRs regime. When the Caribbean Basin Economic Recovery Act of 1983 was finally enacted into law, it required that before the President grants CBI benefits to a prospective beneficiary country, he must (a) find that it does not allow government-owned entities to broadcast copyrighted material, without the express consent of the copyright owners, and (b) take into account the degree to which the country provides adequate and effective protection for intellectual property rights. These issued were raised in subsequent consultations with four governments in the region, prior to their designation as CBI beneficiaries.

Although the CBI programme does not currently have an annual review provision, such as that employed in the GSP, it is possible that the TRIPs issue will arise once more with CBI beneficiaries. This possibility was raised by a provision in the 1988 trade bill, which permits the President to remove a beneficiary country's CBI privileges on a product-specific basis, if he finds that the country no longer meets its designation requirements (including the IPRs provision). This provision gives United States trade officials greater flexibility than they previously had, when a country's benefits were indivisible (i.e. a country either was or was not eligible for duty-free treatment, with no product-specific exceptions). Furthermore, Congress has been considering a CBI reform bill, which is intended to provide better trade benefits for the region. Certain amendments are under consideration that might also add new conditions on CBI benefits, including one proposal that would create a GSP-like review of CBI country practices to be conducted every three years, beginning in 1992.

3. Reciprocity in specific United States intellectual property laws

There is one additional form of coercive negotiation employed by the United States in TRIPs issues. The United States applies a strict definition of reciprocity in the production of intellectual property related to computers. Under the Semiconductor Chip Protection Act of 1984, the United States will provide protection for the mask works of another country's semiconductor chips only if the other country offers similar protection on foreign software, if the country of origin does not provide at least 25 years of protection for software. These provisions are naturally of greater interest to industrialized countries that compete directly with the United States in these fields, than they are to most developing countries. To date, the United States has granted software protection to 18 trading partners, all of which are advanced industrialized countries.

4. Non-coercive bilateralism: technical assistance and mutual agreements

Not all approaches to bilateral TRIPs negotiations rest upon retaliatory measures. The United States also employs non-coercive approaches that do offer alternatives to the threat of sanctions. These include both technical assistance to developing countries, in order to aid them in developing and enforcing stricter regimes for the protection of intellectual property, and the negotiation of mutually-beneficial bilateral trade agreements, that may contain provisions relating to IPRs.

The United States has provided technical assistance to developing countries, both on a bilateral basis and through international organizations. For example, the Commerce Department has trained foreign government officials in the administration of intellectual property laws, offering seminars both in their home countries and in the United States. Similar programmes are sponsored under the auspices of the World Intellectual Property Organization. Congress recently endorsed this approach, including in the 1988 trade law a provision stating the sense of the Congress that

> (1) The Secretary of State should urge international technical organizations, such as the World Intellectual Property Organization, to provide expertise and co-operate fully in developing effective standards, in the General Agreement on Tariffs and Trade, for the international protection of intellectual property rights; and

> (2) Development assistance programmes administered by the Agency for International Development, especially the reimbursable development programme, should, in co-operation with the (United States) Copyright Office and the Patent and Trademark Office, include technical training for officials responsible for the protection of patents, copyrights, trademarks, and mask works in those countries that receive such development assistance.

The provision was purely hortatory, however, and neither made the provision of such assistance mandatory, nor appropriated any funds for this purpose.

Another noncoercive form of IPRs diplomacy is to negotiate bilateral agreements on a variety of trade-related topics, of which IPRs are just one. The United States has hoped to use its recent negotiations with both Canada and Mexico as means for resolving its TRIPs disputes with these neighbours, but the results thus far have been mixed.

In the case of Mexico, United States interest groups have long complained that Mexico does not provide sufficient protection for intellectual property. The Pharmaceutical Manufacturers Association, for example, alleged that Mexico provides inadequate patent terms, and convinced United States officials to deny Mexico more generous treatment in the GSP general review (see above). In the past several years, the United States and Mexico have sought to resolve their differences on TRIPs and a number of other issues, through a series of bilateral "framework" negotiations. Mexico has made some changes in its intellectual property regime. The satisfactory outcome of these talks would appear to indicate that the framework approach is a useful means for the United States and its trading partners in the developing world to resolve their disagreements on TRIPs, without resorting to the threat of retaliation. However, the extent to which different developing countries can resist bilateral initiatives remains an open question.

The Canadian talks represent a more comprehensive approach to bilateral trade liberalization. The United States and Canada implemented on 1 January 1989 a bilateral free trade agreement (FTA) which will eventually lift all tariff barriers between them, and affect many nontariff barriers as well. American officials point to the "new ground" broken ty the FTA in a number of non-traditional issues, as an example of the types of agreements that might be reached in the Uruguay Round. An examination of the FTA reveals, however, just how little they were able to accomplish on this particular issue in the bilateral talks. The United States had hoped for an entire chapter in the FTA devoted exclusively to the TRIPs issue, in order to highlight its importance and establish firm rules. Canadian officials refused to grant this request, and in fact approved just one sentence in the FTA that directly addresses TRIPs. Article 2004 simply states that, "The Parties shall co-operate in the Uruguay Round of multilateral trade negotiations and in other international forums to improve protection of intellectual property". Canadian negotiators had reportedly agreed to include within the accord a clause obligating their nation to enact stricter patent protection for pharmaceuticals, but the domestic opposition to this provision was so intense that it was removed from the agreement at the last moment.

While neither the Mexican nor the Canadian talks have fully resolved United States complaints over IPRs, some policymakers in the United States appear eager to pursue further bilateral or plurilateral agreements along the FTA model. Interest is greatest in discussing such agreements with United States trading partners in Asia and the Pacific. It is possible that, if these talks materialize, they will become an important forum in bilateral TRIPs negotiations.

III. UNITED STATES NEGOTIATING OBJECTIVES IN THE URUGUAY ROUND

This concluding section of the paper briefly examines the steps taken thus far in the Uruguay Round talks on TRIPs. We will not attempt here to assess at length the specific proposals advanced by the United States, and the advantages or disadvantages that these proposals extend for developing countries, nor will we compare them with the positions expressed by other delegations; these tasks have already been undertaken and admirably performed by other analysts.[20] The more limited purpose here is to review the trail of United States demands in the GATT, from the expression of the Congressional intent to the presentation by United States negotiators, and to compare these stated objectives with the status of the GATT talks.

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[20] See for example Paolo Bifani, "Intellectual Property Rights and International Trade", in UNCTAD, *Uruguay Round: Papers on Selected Issues* (United Nations Publication, UNCTAD/ITP/10), pp. 129-83; and UNCTAD, *Trade-Related Aspects of Intellectual Property Rights: Analysis of Proposals and Their Possible Implications for Developing Countries and Suggestions Regarding Possible Approaches* (UNCTAD/MTN/INT/CB/5, 6 September 1988).

Briefly stated, there remains a wide gulf between what the United States has asked for, and what the GATT process has yielded until the Mid-Term Review Decision. While American negotiators hope to win agreement on the need for multilateral rules on TRIPs involving higher levels of IPR protection, stricter enforcement, and the legitimacy of linkage between intellectual property and trade in goods, the chief accomplishment of the TRIPs negotiations appears to have been to keep the discussion going. While the critics of United States demands can take some comfort in this stalemate, the underlying message of this paper will not be equally welcome: if the United States cannot get what it wants on TRIPs through the Uruguay Round, it will press its concerns elsewhere, especially in confrontational, bilateral negotiations. The TRIPs issue is too popular in the United States to expect that it will vanish at the conclusion of the Uruguay Round, with United States interest groups and policymakers accepting whatever agreement is reached (or not reached) as the final judgment. Quite to the contrary, the United States trade policy community considers the GATT talks to be just one option among many, and is quite prepared to use other means to achieve its ends, both during and after the multilateral negotiations. The United States has already indicated its willingness to employ the Section 301 retaliatory mechanism and related provisions of its law as leverage in its TRIPs negotiations, especially with the more advanced developing countries and territories. There is every reason to expect that United States negotiators will continue to employ these coercive approaches, if (a) they believe that the GATT talks have not fully addressed their concerns, and (b) they are not prevented form exercising independent authority, i.e. unless there is some form of restraint on the use of retaliatory trade mechanisms.

The issue facing developing countries is not simply whether or not to meet the United States demands on TRIPs. There are at least four other questions that each developing country might wish to consider. If there is to be a GATT agreement on this issue, what manner of safeguards might be written into it, so as to address the concerns of developing countries? If such an agreement is to be approved, what manner of *quid pro quo* might be sought in other MTN negotiating groups, as compensation to developing countries? If some manner of accommodation is not reached with the United States on TRIPs, will the country face the prospect of coercive bilateral negotiations? Finally, can United States retaliatory initiatives of this sort be more effectively restrained, through negotiation of a more comprehensive GATT agreement on dispute-settlement procedures? These are extremely wide-ranging questions, and cannot possibly be answered here in their entirety. In lieu of presenting answers to these inquiries, the remainder of this paper is devoted to offering observations that might help to direct the search for these answers.

A. TRIPs and the General Agreement

The United States proposal to place intellectual property issues on the GATT agenda represents an attempt to change the permissive character of the General Agreement, as it relates to TRIPs. The original General Agreement clearly does not address TRIPs issues comprehensively, although there are a few provisions that deal parenthetically with the subject. These may be summarized as follows:

- Article IX.6 requires that contracting parties co-operate to prevent the use of trade names "in such a manner as to misrepresent the true origin of a product".

- Article XII provides an exception to General Agreement rules, by allowing import restrictions taken to safeguard a country's balance of payments. Subparagraph (c) (iii) states that the import restrictions should not "prevent compliance with patent, trademark, copyright, or similar procedures".

- Article XVIII permits developing countries to take protective measures to promote economic development, and contains an identical provision to that cited above for Article XII.

- Article XX, subparagraph (d) is a general exception from General Agreement obligations for actions taken to secure compliance with

> patent, trademark, and copyright laws, provided that these laws themselves are not inconsistent with the General Agreement.

These provisions thus incorporate certain TRIPs-related concerns into the General Agreement, but in a limited manner that suggests a general distinction between trade and intellectual property issues. By contrast, the United States proposal would seek to soften this distinction, by making intellectual property protection a legitimate topic of concern in the multilateral trading system.

Representatives of the United States first attempted to construct this linkage late in the Tokyo Round negotiations, when in 1978 they proposed that the participants draft a GATT Code to discourage counterfeiting. Work was not completed on this proposal before the Tokyo Round ended in 1979, and while a draft text was eventually prepared, objections from developing countries prevented other industrialized nations from joining with the United States in its approval. Further negotiations on TRIPs issues awaited inauguration of the new round.

It took several years for the United States to win approval for inclusion of TRIPs issues on the negotiating agenda. Following examination of the subject by a group of experts (who restricted their inquiry to technical matters, and made no recommendations on the political question of whether TRIPs issues should be dealt with in GATT), consultations with WIPO officials over their role in such talks, and lengthy disagreements between developing and industrialized countries, the GATT contracting parties finally agreed in the Punta del Este conference of 1986 to include the item in the Ministerial Declaration on the Uruguay Round. The document stated *inter alia* that

> In order to reduce the distortions and impediments to international trade, and taking into account the need to promote effective and adequate protection of intellectual property rights, and to ensure that measures and procedures to enforce intellectual property rights do not themselves become barriers to legitimate trade, the negotiations shall aim to clarify General Agreement provisions and elaborate as appropriate new rules and disciplines.

The negotiating parties also agreed to consider rules and disciplines on trade in counterfeit goods (which implies a less controversial aspect of the TRIPs issue than the paragraph cited above), and agreed that the talks on intellectual property shall proceed "without prejudice to other complementary initiatives that may be taken in the World Intellectual Property Organization and elsewhere to deal with these matters".

The document provided an opportunity for the United States and its negotiating partners to engage in potentially wide-ranging negotiations on TRIPs. It was in the presentations of individual contracting parties that the possible parameters of a TRIPs agreement were proposed.

B. United States negotiating objectives

The United States negotiating objectives on TRIPs are established in three distinct documents: the Reagan administration's 1986 paper on intellectual property policy, the formal expression of negotiating objectives in the Omnibus Trade and Competitiveness Act of 1988, and the proposal advanced by the United States delegation to the Uruguay Round talks in 1987 (together with subsequent submissions expanding upon these views). These statements are each consistent with one another, but can be distinguished by the different purposes that they serve. The 1986 policy announcement stated United States objectives in intellectual property generally, and underlined the point that the multilateral talks are by no means the only forum in which this topic may be raised. The 1988 trade law set United States goals in a wide variety of fields, including TRIPs, and established alternative negotiating mechanisms for their achievement (e.g. offers to concessions and threats of retaliation). The proposals advanced by United States negotiators on TRIPs are in fact the only documents that focus exclusively on the issue of intellectual property in the context of the Uruguay Round. This section examines these objectives, first by reviewing the language in the trade law, and then with reference to the United States proposals in Geneva.

Section 1101(b)(10) of the 1988 trade law lays out the principal United States negotiating objectives regarding TRIPs, stating that the United States will seek to convince its trading partners to enact and enforce laws that "recognise and adequately protect intellectual property, including copyrights, patents, trademarks, semiconductor chip layout designs, and trade secrets", and "provide protection against unfair competition". This aspect of the United States objectives is expressed apart from the goal of obtaining a multilateral agreement on TRIPs. It implies that the United States is ultimately more concerned with the practical results it can obtain with its trading partners (i.e. meaningful changes in their laws and policies), than with the question of whether these results are best obtained through bilateral or multilateral means.

With respect to the General Agreement, the trade law directs United States negotiators to seek the establishment of an obligation for GATT contracting parties to implement adequate substantive standards for IPRs, based either on "the standards in existing international agreements that provide adequate protection" or "the standards in national laws if international agreement standards are inadequate or do not exist". The law further directs United States negotiators to seek a General Agreement rule that would oblige countries to enforce these standards. As a fallback position (i.e. if a country does not in fact enforce the standards), United States negotiators are to seek the creation of effective dispute-settlement procedures in the GATT. The law reiterates the United States view that these GATT initiatives are undertaken "without prejudice to other complementary initiatives undertaken in other international organizations", e.g. WIPO.

These negotiating objectives are complemented by a clause within Section 1101(b)(8) of the 1988 trade law, which sets the United States objectives on unfair trade practices. This provision directs United States negotiators *inter alia* to

> obtain the enforcement of General Agreement rules against . . . the acts, practices, or policies of any foreign government which, as a practical matter, unreasonably require that . . . intellectual property be licensed to the foreign country or to any firm of the foreign country.

The spirit of this provision suggests the difficulties that United States negotiators would face, if they were to consider a compromise on the issues of TRIPs and technology transfer. For example, it might be suggested that developing countries make certain commitments on intellectual property protection, in exchange for promises of accelerated technology transfer by the industrialized countries. Even if United States negotiators were to be favourably disposed towards such a proposal, they would ultimately face considerable opposition from Congress and United States industry, were they to submit the agreement for domestic ratification.

Although the negotiating objectives discussed above are reasonably clear, it should be noted that they do not appear entirely consistent with another goal stated in the 1988 trade law. Section 1101(b)(15) expresses the United States goals with respect to high technology, these being

> to obtain the elimination or reduction of foreign barriers to, and acts, policies, or practices by foreign governments which limit equitable access by United States persons to foreign-developed technology, including barriers, acts, policies, or practices which have the effect of
>
> (1) restricting the participation of United States persons in government-supported research and development projects;
>
> (2) denying equitable access by United States persons to government-held patents;
>
> (3) requiring the approval or agreement of government entities, or imposing other forms of government interventions, as a condition for the granting of licenses to United States persons by foreign persons (except for approval or agreement which may be necessary for national security purposes to control the export of critical military technology); and
>
> (4) otherwise denying equitable access by United States persons to foreign-developed technology or contributing to the inequitable flow of technology between the United States and its trading partners.

The objective responds to the United States concerns over targeting policies employed by other industrialized countries, especially Japan, which are alleged to restrict the access of United States industries to new technologies. It is difficult to discern a substantive difference between this negotiating objective, and the argument that strict IPRs enforcement may constitute an unreasonable barrier to the transfer of technology. This negotiating objective does direct United States negotiators to "take into account United States Government policies in licensing or otherwise making available to foreign persons technology and other information developed by United States laboratories" in pursuing this objective, but does not instruct them on how they are to reconcile this technology-transfer goal with their previous attempts to dimiss similar objectives on the part of their counterparts in developing countries.

The United States objectives on TRIPs were more specifically articulated by the country's delegation to the Uruguay Round. The United States delegation tabled its intellectual property proposal on 27 October 1987. This document, declared that IPRs protection is "essential to the expansion of international trade, investment, economic development, and, as some countries have noted, the beneficial distribution of technology." It acknowledged that the current international regime has "assisted in producing the level of intellectual property protection available today", but stressed that these "conventions were never intended to be used as enforcement mechanisms". The United States argued that intellectual property issues should be integrated into the General Agreement framework as a supplement to the existing arrangements.

The United States proposed that a set of agreed norms be developed and adopted to achieve these objectives. The norms would be based in part on existing national laws, but would set a standard against which new national laws would be judged. GATT members would be encouraged to adopt higher standards of IPR protection in their national legislation. It is possible that the United States would conduct such encouragement through means more forceful than rhetorical. These possibilities are discussed at the conclusion of this section.

C. Interim agreement in the Uruguay Round

Although the Uruguay Round negotiations on TRIPs have covered a great deal of ground, their concrete accomplishments - i.e. agreement among GATT contracting parties on specific principles and commitments - have not progressed substantially. The United States and numerous other industrialized and developing countries have presented their proposals, many meetings have been held, and participants have drawn upon the expertise of the GATT Secretariat and other relevant international organizations in this field. For all of this activity, however, the language agreed to in April 1989 on TRIPs is little more than an agreement to disagree. The text recognizes the importance of intellectual property and its place on the Punta del Este Declaration, notes which aspects of the issue will continue to receive attention in the negotiations, and agrees that consideration will be given to the concerns expressed by developing countries.

Even a cursory reading of this text indicates that the fourth and fifth paragraphs represent the crux of the debate. The fourth paragraph suggests those areas in which the United States and other industrialized countries hope to win agreement; the issue for these countries is not whether to establish commitments in the five areas named by this paragraph, but on precisely what terms. By contrast, the fifth paragraph recognizes the concerns expressed by some developing countries regarding the possible consequences of establishing a strict IPRs regime. Resolving the controversy over TRIPs will require that either one or the other of these two paragraphs be laid aside, or that some compromise be struck between them.

The reaction in the United States to this interim language has been subdued. Several United States interest groups have indicated satisfaction with the fact that the talks are continuing, as well as realistic understanding of the pace with which GATT negotiations can proceed, and generally appear optimistic that the Uruguay Round will ultimately yield a TRIPs agreement that addresses at least some of their concerns. These groups remain troubled, however, by the apparent tensions between the two key paragraphs. These views were expressed by a spokesman for the Intellectual Property Committee, who told a Congressional committee in late April, 1989:

> We would have preferred not to have paragraph (5) included in the framework. It represents an attempt by countries opposed to strong protection to introduce into the negotiations permanent derogations from effective and adequate intellectual property protection for development, technological and other public policy reasons. Unfortunately, these countries incorrectly believe that the path to economic development lies in imitation and piracy rather than in creativity and innovation. The actual language of paragraph (5), however, is acceptable in that it represents the reality of the negotiations. In the negotiations on the five substantive elements listed in paragraph (4), countries will be able to raise, and consideration will be given to, relevant concerns that are related to the underlying public policy objectives of intellectual property pro-

> tection systems. The framework language, however, clearly does not require that the negotiations take into account these misplaced concerns.[21]

This statement underlines the continued disagreement between the United States and several developing countries, and suggests that the gulf between United States demands and accomplishments in the talks remains wide.

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[21] Testimony of the Intellectual Property Committee before the Senate Finance Committee, 20 April 1989, p. 3.

Box 1

UNITED STATES OPTIONS IN TRIPS ENFORCEMENT

Unilateral enforcement

Objective	*Approach*	*Instrument*
Protect intellectual property from violators in the home market.	Enact domestic laws; empower administrative bodies and the courts system to enforce these rules.	Article 1, Section 8 of the Constitution, the Patent Act of 1790, and all subsequent domestic TRIPs laws establish legal regime.
Prevent the spread of intellectual property abroad.	Impose restrictions on the exportation of technology, capital goods, etc.	Export Administration Act of 1979 restricts exports of militarily-critical technology; most other technology may be exported.
Restrict imports of TRIPs-violating goods.	(a) Block imports at the border;	Section 337, Tariff Act pf 1930 allows TRIPs owners to petition for cease-and-desist or exclusion orders.
	(b) Prohibit sales of these imports in domestic commerce.	Patent laws allow intellectual property owners to sue importers, distributors, and purchasers of violating goods.

International negotiations

Objective	*Approach*	*Instrument*
Prevent production of TRIPs-violating goods abroad, whether for sale in the producing country, the United States, or third-country markets.	(a) Compel foreign governments to enact and enforce stricter laws;	USTR employs Section 301, Special 301, and GSP/CBI laws to link a country's market access to its TRIPs regime; some US laws have reciprocity provisions.
	(b) Reach mutual agreements with foreign governments on TRIPs issues.	Bilateral free trade agreements and other accords can include TRIPs sections.
Obtain multilateral consensus on the intellectual property issue.	Pursue diplomatic initiatives in international bodies; seek legal disciplines at international level.	The United States participates in the Uruguay Round, WIPO, and other international fora.

Box 2

UNITED STATES INTELLECTUAL PROPERTY COMPLAINTS AGAINST DEVELOPING ECONOMIES, LISTED IN THE 1989 NATIONAL TRADE ESTIMATE

Argentina: no process patent protection for pharmaceuticals; no explicit copyright protection for software.

Brazil: no product or process patents for chemicals, foodstuffs, or pharmaceuticals; patents must be worked; restrictive licensing requirements; problems with enforcement of copyright law.

Chile: no patent protection for beverages, chemical preparations, reagents and combinations, or pharmaceuticals.

China: no copyright protection for software; no patent protection for chemicals or pharmaceutical products.

Colombia: no patent protection for certain items; insufficient five-year patent term (although it can be extended for another five-year term); working requirements; compulsory licensing provisions and license restrictions; not a member of the Paris Convention for the Protection of Industrial Property.

Egypt: no copyright protection for collective works (e.g. data bases); compulsory license for broadcasting works in public establishments; limitation of exclusive translation rights into Arabic to five years from publication; inadequate penalties and unclear basis for protecting new technologies; no patents for chemical processes that produce food or medicine; inadequate 15-year patent term from date of application; patent renewal restrictive; inadequate compulsory license requirements; patents forfeited if not worked.

Gulf Co-operation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates): no copyright protection laws; inadequate trademark enforcement.

India: inadequate patent protection overall; no patent protection for food-, medicine-, or pharmaceutical-related inventions; inadequate copyright enforcement; deficiencies in compulsory licensing; overly broad copyright exemptions; restrictive trademark-registration restrictions, especially for "foreign" trademarks; no protection for service marks.

Indonesia: no patent law; inadequate (but improving) copyright enforcement; weak (but improving) trademark enforcement.

Malaysia: excessively broad copyright compulsory licensing rights.

Mexico: no patent protection for some items; new applications for known inventions; compulsory licensing burdens; excessive business information requirements; trademarks subject to compulsory licenses; inadequate trade secret protection and enforcement; proprietary information disclosure requirements leading to inadequate protection; legal limits on royalty payments to foreign companies; inadequate copyright enforcement.

Nigeria: inadequate copyright protection; excessive requirements to prove copyright ownership.

Pakistan: no product patent protection for pharmaceuticals and agrichemicals; inadequate process patent protection; overly accessible compulsory licensing; inadequate copyright enforcement; inadequate trademark registration; no service mark registration.

Philippines: excessive patent working requirements; compulsory licensing; technology transfer laws include royalty caps and may not prohibit exports; weak patent, trademark, and copyright enforcement; contradictory trademark requirements; publishers may reprint educational, scientific, and cultural books above a certain value; book royalty cap; royalty caps on trade secrets.

Box 2 (continued)

UNITED STATES INTELLECTUAL PROPERTY COMPLAINTS AGAINST DEVELOPING ECONOMIES, LISTED IN THE 1989 NATIONAL TRADE ESTIMATE

Republic of Korea: inadequate patent, copyright, and trademark laws; inadequate enforcement.

Taiwan, Province of China: inadequate copyright and trademark enforcement; excessive trademark registration requirements; no patent protection for micro-organisms, foodstuffs, semiconductors, or new animal and plant varieties; excessive compulsory licensing provisions; patent law favours infringers. *Thailand*: no product patent protection for food and beverages, pharmaceuticals and pharmaceutical ingredients, or agricultural machinery; insufficient patent term; overly broad compulsory licensing provisions; patent must be worked; no service, certification, or well-known trademark protection; inadequate trademark protection enforcement, inadequate copyright protection enforcement; public performance copyright exceptions; 10-year limit on translation rights.

Venezuela: no patent protection for certain items; insufficient patent term; patent working requirements; restrictions on licenses; not a member of the Paris Convention for the Protection of Industrial Property; inadequate trademark protection enforcement; no service mark protection; no explicit software copyright protection; weak copyright enforcement.

Yugoslavia: inadequate patent protection; compulsory licensing provisions; no patent protection for chemical compounds or compositions, alloys, pharmaceuticals, or agricultural chemicals; overly restrictive chemical technology patent availability.

Source: Office of the US Trade Representative, *1989 National Trade Estimate Report on Foreign Trade Barriers* (1989).

Note: Box paraphrases the complaints; see original for full text.

Table 1

RELATIVE VULNERABILITY OF SELECTED UNITED STATES TRADING PARTNERS TO THREATS OF COMMERCIAL RETALIATION

(in millions of current dollars and percentages)

	1987 Exports to United States				*1988 Exports to US receiving GSP treatment* [a]
	Total	*As per cent of all exports*	*As per cent of GNP*	*Status in GSP & CBI*	
Asian NIEs					
Hong Kong	13,511	27.9	29.8	Graduated	1,859 [b]
Republic of Korea	18,362	38.9	16.3	Graduated	2,766 [b]
Singapore	7,000	24.5	33.8	Graduated	1,809 [b]
Other Asia and Pacific					
China	3,030	7.7	0.9	Not eligible	0
India	2,478	19.9	1.0	GSP	349
Indonesia	3,335	20.2	4.3	GSP	87
Malaysia	2,972	16.6	10.1	GSP	634
Pakistan	463	11.1	1.3	GSP	63
Philippines	2,060	36.2	5.9	GSP	508
Thailand	2,120	18.8	4.7	GSP	714
Latin America					
Argentina	958	15.0	1.3	GSP	314
Brazil	7,666	28.8	2.4	GSP	1,319
Bolivia	103	17.9	2.5	GSP	10
Chile	1,048	21.6	6.4	GSP suspended	19
Colombia	2,195	41.9	6.1	GSP	147
Dominican Republic	1,106	83.6	22.4	GSP & CBI	138
El Salvador	273	44.4	6.5	GSP & CBI	15
Guatemala	493	50.6	7.2	GSP & CBI	23
Mexico	18,654	69.6	12.5	GSP	2,188
Peru	716	27.5	2.4	GSP	155
Uruguay	177	15.0	2.7	GSP	50
Venezuela	5,346	50.3	11.1	GSP	192
Other developing					
Egypt	453	9.8	1.3	GSP	6
Nigeria	3,424	41.3	8.7	Not eligible	0
Saudi Arabia	4,442	16.6	5.3	Not eligible	0
Yugoslavia	758	5.8	1.3	GSP	300

Source: Trade and GNP figures calculated from International Monetary Fund's DOTS data and World Bank data. GSP and CBI data and status from USTR.

[a] Value of imports that actually entered duty-free under GSP in 1988; value of potentially eligible products is generally higher.

[b] Each of these trading partners was eligible for GSP in 1988, but was graduated as of 1 January 1989.

ANTI-COMPETITIVE PRACTICES IN THE SERVICES SECTOR

*Philippe Brusick, Murray Gibbs and Mina Mashayekhi**

INTRODUCTION

Several participants in the Group of Negotiations on Services (GNS) have proposed that a multilateral framework for trade in services should contain provisions dealing with restrictive business practices (RBPs) and other anti-competitive practices of private enterprises. Despite the initial reluctance of some participants, there would now appear to be a wider acknowledgement of the need to address this issue. This paper addresses some of the restrictive and anti-competitive practices in the services sector. Section I defines restrictive business practices and lists some of the major forms they take. Section II describes the multilateral efforts to control RBPs. Section III examines RBPs in the context of trade liberalization. Section IV discusses some of the significant RBPs which have been identified in a number of service sectors. Section V considers the effects of RBPs and newer forms of anti-competitive practices in the light of the internationalization of markets and the application of new technologies. Section VI traces the implications of these issues for the Uruguay Round negotiations on trade in services.

I. RESTRICTIVE BUSINESS PRACTICES

Enterprises may acquire a dominant position of market power (DPMP) at least temporarily through fair competition, by creating a reputation of quality or through innovation or astute business methods.

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* The authors are members of the UNCTAD secretariat.

However, an enterprise can also use less justifiable practices to distort competition to its advantage through restrictive business practices which are measures adopted by enterprises to artificially increase market power, to attain a DPMP, and/or to abuse its position of dominance in a market by raising prices and excluding new entrants. To counter such practices, most developed countries and a growing number of developing countries have adopted laws to ensure competition; most of such laws apply both to goods and services. For developing countries not only is the detection and control of RBPs technically more difficult, but RBPs - including those in the categories mentioned below - have a potentially greater impact on their trade.

Traditionally, competition laws have been designed to address four main types of RBPs:

- Conspiracies between firms to eliminate competition, by reaching agreement among competitors to fix prices and allocate markets in cartel agreements;

- Activities aimed at eliminating competitors through refusal to deal, resale price maintenance, tied selling and predatory pricing, used by firms in order to gain or reinforce dominant positions in markets where they are major suppliers;

- Efforts by firms to acquire a DPMP through takeovers, mergers and acquisitions; and

- Efforts by firms to acquire a DPMP through control over technology, through various techniques which have been addressed in the draft Code of Conduct on the Transfer of Technology, as described below.[1]

II. MULTILATERAL EFFORTS TO CONTROL RBPS

The impact of RBPs on trade in goods and services has been long recognized by the international community. Chapter V of the the

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[1] In the latter case there are some fundamental contradictions between competition law which seeks to limit or abolish exclusive and monopoly rights and intellectual property right legislation which serves to create such rights.

Havana Charter contained clauses aimed at regulating RBPs in international trade. In particular, this chapter contained an article 53 on "Special Procedures with respect to Services", which addressed restrictive business practices in "certain services such as transportation, telecommunications, insurance and the commercial services of banks".[2] Although the RBP provisions of the Charter were not incorporated into the General Agreement, there was recognition in the GATT of the fact that the activities of international cartels and trusts might hamper the expansion of world trade and the economic development in individual countries and thereby frustrate the benefits of tariff reductions and of the removal of quantitative restrictions or otherwise interfere with the objectives of the General Agreement. In 1958, the GATT contracting parties adopted a resolution appointing a Group of Experts to study and make recommendations with regard to RBPs in international trade.[3] The Group of Experts adopted a report in 1960 on arrangements for bilateral or multilateral consultations on RBPs and the necessity of further measures.[4] No agreement was reached, however, on the nature of further measures due to differences of views among-the experts.[5] On the basis of the report adopted by the Group of Experts, the Contracting Parties recommended an arrangement for consultations in November 1960.[6]

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[2] United Nations Conference on Trade and Development: Final Act and Related Documents, Interim Commission for the International Trade Organization, Lake Success, New York, April 1948; see also United Nations document ICITO 1 4.

[3] See *BISD*, Seventh Supplement, p. 29.

[4] See the report adopted on 2 June 1960, L. 1015, at *BISD*, Ninth supplement, p. 170.

[5] The majority view held by experts from Austria, Canada, the Federal Republic of Germany, Japan, Netherlands, Switzerland, the United Kingdom and the United States of America, was that it would be unrealistic to recommend a multilateral agreement for the control of RBPs at that time. Such agreement, in their opinion, could not operate effectively unless a sufficient number of countries had powers to act against international restrictive business practices in accordance with such an agreement, or were able and willing to adopt such powers, or unless the agreement incorporated a supra-national body with broad powers of investigation and control. The majority, therefore, recommended direct consultation between contracting parties with a view to the elimination of the harmful effects of particular restrictive practices. The minority view held by experts from Denmark, France, Norway and Sweden was that a group of experts should examine the cases of RBPs reported and if necessary enter into consultation with the parties concerned with a view to reaching satisfactory settlement. They proposed concrete procedures to deal with RBPs including those in services for a period of three years, at the end of which the group would have had the possibility of assessing the real importance of RBPs in international trade and of appreciating the nature of their effects and of the difficulties encountered in reaching solutions and therefore would be in a position to submit proposals to the contracting parties for possible improvement of the procedure.

Work undertaken at UNCTAD in the early seventies led to an agreement at UNCTAD IV in Nairobi[7] that RBPs can adversely affect international trade, particularly that of developing countries as well as the economic development of these countries, and that action should be taken at the international level, including negotiations with the objective of formulating a set of principles and rules for the control of restrictive business practices. In 1980, negotiations pursuant to this Resolution resulted in the adoption of Resolution 35/63 by the United Nations General Assembly, which incorporated the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices.[8] The Set, a comprehensive multilateral instrument in the form of a voluntary code covering "all transactions in goods and services". (Section B, para.5), addresses the actions of enterprises (including transnational corporations) as well as of States, at national, regional and subregional levels. It calls for international measures, including consultation procedures and technical assistance for developing countries. Its institutional machinery is provided by the Intergovernmental Group of Experts (IGE) on Restrictive Business Practices, at UNCTAD. The ninth session of the IGE (23-26 April 1990) acted as the preparatory body for the second United Nations conference to review all aspects of the Set (the Review Conference), scheduled to take place on 26 November - 7 December 1990. As a result of the progress achieved at the IGE, it is expected that the Review Conference will especially focus on issues related to technical assistance, transparency and consultation mechanisms in the field of RBPs adversely affecting international trade, particularly the trade and development of developing countries.

After nearly ten years of existence of the Set, views about its implementation and application differ considerably. The developed countries, generally, consider that the Set has been implemented satisfactorily and that the main thrust of its application depends on the capability of developing countries to adopt and efficiently apply national RBP laws. The developing countries, however, have on various occasions complained that the Set had barely been implemented since RBPs were continuing to adversely affect their trade and development. Developing countries are concerned that developed countries are not applying the Set so as to restrain their enterprises from engaging in RBPs adversely affecting developing countries, and recognize that the implementation of their national legislation remains faced with tremendous difficulties when encountering RBPs originating from abroad. They have proposed improvement to the Set, including with respect to transparency (i.e. collection and supply of information necessary for investigation), and the need for defining improved consultation and relief procedures.[9]

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[6] See Decision of 18 November 1960 on RBPs - "Arrangement for Consultations" in *BISD*, Ninth Supplement p. 28.

[7] UNCTAD IV, resolution 96/IV, Nairobi, 1976.

[8] The Set, as adopted by the General Assembly, is contained in document TD/RBP/CONF/10/Rev.1.

Restrictive business practices are also addressed in the draft Code on the Transfer of Technology. Its Chapter 4 identifies a series of measures including grant-back provisions, exclusive dealing, restrictions of research, restrictions on use of personnel, price fixing, restrictions on adaptations, exclusive sales or representation agreements, tying arrangements, export restrictions, patent pool or cross-licencing agreements, restrictions on publicity, etc.[10] Such practices have been addressed in competition law and intellectual property legislation in a large number of countries at various levels of development.[11] The draft Code of Conduct on Transnational Corporations provides that "for the purposes of this Code", the relevant provision of the Set of Principles and Rules for the Control of Restrictive Business Practices "shall also apply in the field of Restrictive Business Practices". The draft Code also contains provisions to the effect that transnational corporations "should avoid practices which adversely effect the international flow of technology". Transfer pricing and actions to "modify the tax base on which their (i.e. TNC) entities are assessed" are also prohibited.

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[9] See *Report of the IGE on Its Ninth Session* (UNCTAD Document No. TD B 1261; TD B RBP 76).

[10] See TD Code TOT 47, United Nations, 1985.

[11] See UNCTAD *Control of Restrictive Practices in Transfer of Technology Transactions* (United Nations Publication, Sales No. E.82.II.D.8).

Two instruments of the Organisation for Economic Co-operation and Development (OECD) address restrictive business practices affecting international trade in goods and services. They are (a) the OECD Guidelines for Multinational Enterprises, which is an annex to the 1976 Declaration on International Investment and Multinational Enterprises, and (b) the OECD 1986 Recommendation, which reiterates the main provisions of three previous recommendations adopted in 1967, 1973 and 1979, and adds new guiding principles. In 1982 the OECD Committee of Experts on Restrictive Business Practices (later re-named Committee on Competition) had established a Working Party on Competition and International Trade with the following terms of reference:

> To examine, in particular, possible long-term approaches to developing an improved international framework for dealing with problems arising at the frontier of competition and trade policies.

The findings and recommendations of the Working Party are contained in an OECD Report.[12]

A major issue dealt with in the report is "the involvement of governments in RBPs affecting international trade, through the granting of exemptions from competition laws, *de facto* acceptance, advice, encouragement or even compulsion. In some instances RBPs by enterprises are in close correlation with restrictive trade practices".[13] The report goes on to recommend, *inter alia*, that

> the governments of the countries where export cartels are located should [also] be ready to cooperate, as far as their laws permit, with the competitive authorities of other countries in any investigation into possible anti-competitive effects of arrangements located in their countries, recognizing the jurisdictional difficulties that sometimes arise when information is sought from abroad or where the parties to a restrictive agreement are located abroad. The OECD 1979 Council Recommendation concerning cooperation on RBPs affecting international trade, the 1976 OECD Guidelines for Multinational Enterprises, as well as the United Nations Set of Multilaterally Agreed Equitable Principles and Rules, remain appropriate instruments for such cooperation.[14]

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[12] OECD, *Competition and Trade Policies: Their Interaction* (Paris, OECD, 1984).

[13] *Ibid.*, p. 12.

[14] *Ibid.*, p. 15.

The report also notes that

> there are a number of other practices that are common features in commercial transactions on the domestic and international levels. From the standpoint of competition policy, one principal concern is that the terms and conditions in the vertical distribution of goods and *services* or in the transfer of technology, are not abused to allocate and divide world markets.[15]

Neither the Guidelines nor the Recommendation defines multinational enterprises with legal precision. The Guidelines clarify that multinational enterprises comprise "companies or other enterprises whose ownership is private, state or mixed, established in different countries and so linked that one or more of them may be able to exercise a significant influence over the activities of the others and, in particular, to share knowledge and resources with others". It specifies that enterprises should refrain from anti-competitive actions by abusing a DPMP by, e.g. anti-competitive acquisitions, predatory behaviour towards competitors, unreasonable refusal to deal, anti-competitive abuse of industrial property rights, discriminatory pricing, etc. It also provides that these enterprises should "allow their component entities freedom to develop their activities and to exploit their competitive advantage in domestic and foreign markets." The OECD 1986 Recommendation includes provisions for notification, exchange of information, co-ordination of action and, in the case of grievances, for consultation and conciliation. It recommends that, subject to appropriate safeguards, the competent authorities of one member country should allow the disclosure of information to such authorities of member countries by other parties concerned.

All these instruments - i.e. the Set, the OECD 1986 Recommendation and the OECD Guidelines - emphasize voluntary action and a pragmatic, rather than legalistic, approach. They stress procedures for consultation and clarification of problems. Multilateral action on RBPs focus on the improvement of transparency, strengthening of co-operation between national authorities, and the provision of guidelines for national legislation. It is considered that the Guidelines constitute an important balancing element to the commitments undertaken by governments under the OECD codes and the national treatment instrument.[16] Liberalization in the OECD, including the acceptance of obligation with respect to national treatment, has been facilitated by the fact of at least some measure of discipline over the activities of transnational corporations. The absence of any comparable discipline at the multilateral level has prompted countries to impose conditions on the entry or establishment of foreign firms to pre-empt their possible resort to anti-competitive practices. Such conditions include (a) local content provisions, (b) manufacturing requirements, (c) domestic sales requirements, (d) export performance requirements, and (e) technology transfer and licensing requirements.

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[15] *Ibid.*, p. 17.

III. RBPS IN THE CONTEXT OF TRADE LIBERALIZATION

The importance of RBPs as a possible barrier to trade in goods and services was clearly recognized by all States which adopted The Set of Principles and Rules for the Control of Restrictive Business Practices, which set as objective No.1 of the code:

> To ensure that restrictive business practices do not impede or negate the realization of benefits that should arise from the liberalization of tariff and non-tariff barriers affecting world trade, particularly those affecting the trade and development of developing countries.[17]

Domestic legislation on RBPs usually consist of rules governing the behaviour of enterprises in the market and aiming to strengthen competition and rules to discourage industrial concentration.

When domestic markets are protected by a variety of restrictions, differences in competition laws as between countries may not have a major effect on trade; the traditional anti-competitive practices, such as dumping and transfer pricing, have been dealt with in the laws of the importing country.[18] In an interdependent world, however, different degrees of stringency in the determination of governments to discipline anti-competitive practices can result in some markets being more open than others and some countries having additional advantages in export competition. Enterprises may seek to frustrate trade liberalization undertaken by governments through practices designed to protect or control markets. Governments have thus come to realize that efforts at trade liberalization would not achieve their desired results unless accompanied by appropriate competition laws. For example, the founders of the European Economic Community were conscious that to create a truly common market, it was imperative to complement efforts to eliminate governmental trade barriers with a system of control of anti-competitive practices. This led to the adoption of articles 85 and 86 of the Treaty of Rome, which deal with issues of competition in trade between member countries. Article 85(1) prohibits

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[16] See R. Geiger, "Lessons for the Experience of the OECD", in *The Uruguay Round: Services in the World Economy* (New York, UNCTC World Bank, 1990).

[17] The Set was unanimously adopted by all States in General Assembly resolution 35/63 of 5 December 1980.

[18] Although article VI of the General Agreement exhorts contracting parties to discourage dumping.

> any agreement between enterprises, any decisions by associations of enterprises and any concerted practices which are likely to affect trade. . . and which has as their object or result the prevention, restriction, or distortion of competition within the Common Market.

Article 86 prohibits enterprises from unfairly or improperly taking advantage, individually or in concert, of a "dominant position". As described in the examples given below, the Commission of the European Communities scrutinizes services, such as banking and insurance, sea and air transportation, in search of breach of rules on competition.

The application of laws to ensure competition in domestic markets of developed countries has not been accompanied by concomitant attention to the activities of their firms in foreign markets. On the contrary, the formation of export cartels and consortia appears to have been tacitly encouraged. In the debate surrounding the implementation of The Set of Principles and Rules, developed countries have consistently taken the position that the activities of their firms outside their countries are exclusively a matter for the competition laws of the host countries concerned.

IV. RBPS IN THE SERVICES SECTORS

Precise information on the existence and impact of RBPs can be derived from specific cases dealt with under the competition laws of those countries most diligent in combatting anti-competitive practices. A number of recent cases of RBPs in specific service industries are summarized below as a means of illustration.

A. Insurance

Cartel-type agreements to fix insurance premiums and preserve markets are known to exist in this sector. For example, in Switzerland the Cartels Commission found that the Swiss goods insurers' association (ASAC)[19] which controls more than 97 per cent of the market for the insurance of goods and sets uniform premiums and conditions, was the cause of excessive pricing. In its conclusions, the Commission recommended that the ASAC abandon its cartel pricing system.

In the United Kingdom, as a result of pressure from the Office of Fair Trading, the Life Insurance and Unit Trust Regulatory Organization announced in April 1988 its decision to abandon the decade-old cartel which had fixed commissions payable to insurance brokers, banks and building societies.[20]

In the United States, class action was filed on 21 March 1988 alleging that four major United States insurance companies and several British firms had conspired to restrain the United States market for comprehensive general liability insurance.[21] This is a type of insurance used by business, state administrations and municipalities to protect themselves from liability for general damage claims. In another case in the United States[22] the Supreme Court declined to review an Eighth Circuit decision reinstating boycott charges against underwriters of workers' compensation insurance in Minnesota. The suit in question, brought to the courts by some Minnesota employers, charged the underwriters with conspiring to boycott insurers who would not agree to charge the maximum lawful rate set by the State insurance commissioners. The Eighth Circuit Court had found sufficient evidence of the existence of a boycott to use the clause of exception to antitrust immunity contained in Chapter 3(b) of the McCarran-Ferguson Act.

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[19] Association suisse des assureurs de choses, cited in *La Tribune de Genève*, 21 December 1988.

[20] *The Financial Times*, 27 April 1988.

[21] *ATRR*, Vol. 54, No. 1358, 24 March 1988.

[22] *ATRR*, Vol. 57, No. 1423, 6 July 1989.

In yet another case, five major national title insurance companies were found by the United States Federal Trade Commission to have illegally combined to fix their prices for search and examination services through their participation in "rating bureaux" in six States.[23]

B. Banking and financial services

A common cartel-type arrangement among banks involves their agreeing upon common commissions and prices, as well as the fixing of interest rates and foreign-exchange rates. In Switzerland, for example, the bank cartel, in which most leading banks are members, sets uniform foreign exchange rates as well as interest rates. Such practices have been considered anti-competitive in other countries. For example, in 1985, the Swedish Competition Ombudsman obtained an undertaking that banks would decide on their interest rates independently and refrain from informing other banks or banking organizations before a decision was taken in this respect.[24]

The Commission of the European Communities has adopted a number of formal decisions concerning the banking sector. It should be noted, however, that with respect to interest rates, the Commission has decided to reserve its position, pending its enquiry into the relationship between interest rates and the monetary policy of the individual member States. In the case of the Belgian association of banks (Belgische vereinigung der banken / Association belge des banques, BVB/ABB), to which 84 of the 86 banks in Belgium belong, the Commission objected to restrictive practices in respect of the rates charged by the banks for their services. Following discussions with the Commission, the BVB/ABB decided to abandon such practices which directly affected customers. Three other agreements applying to inter-bank relations were exempted from article 85(1) because they were found to contribute to improving the services provided to customers and because the rates charged in inter-bank relations were only maxima and did not necessarily distort competition.[25]

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[23] In *Ticor Title Insurance Co.*, FTC Dkt No.9190, 19 September 1989 cited in *ATRR* Vol. 57, No. 1438, 26 October 1989.

[24] *Competition Policy in OECD countries, 1985-1986*, p. 193.

The phenomenon of concentration of market power is observable in the banking and financial services sector. Like in other sectors, banks and financial institutions are subject to mergers and takeovers, and can apply predatory measures against smaller competitors in order to drive them out of the market. However, what distinguishes banks and financial institutions is the special role they provide in financing to firms in other sectors of the economy. In most countries they have considerable holdings in numerous non-banking enterprises as well. Their managers are represented on boards of directors of other enterprises; thus, through interlocking directorships as well as through loan policies they can considerably influence the actions of non-banking enterprises. Without the financing facilities offered to some customers - and refused to others - by large banks and financial institutions, leveraged buy-outs (LBOs) and other forms of takeover leading to concentration of market power between enterprises could not occur.

C. The advertising sector

The practice of refusal to deal has often come to the attention of RBP control authorities with respect to advertising in newspapers and other media. For example, in 1980, the Swiss Cartels Commission investigated cases related to refusals to deal in the media, and in particular the collective refusal by importers of motor vehicles to place advertisements in a local newspaper which had previously criticized excessive pricing practices of the importers in question.[26]

Publishers and newspapers have also refused to accept advertisements for a variety of reasons. In Sweden, a publisher refused to accept advertisements for motor vehicle spare parts. Upon investigation by the Competition Ombudsman, it was found that the publisher himself was a supplier of spare parts for motor vehicles.[27] In Belgium, a publisher who had large advertising contracts with importers of electrical appliances refused an advertisement for a competing parallel importer.[28]

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[25] Commission of the European Communities, *Sixteenth Report on Competition Policy, 1987*, p. 70.

[26] See UNCTAD, *Annual Report 1981*, document TD/B/RBP/9, para. 9.

The United States Department of Justice charged three advertising companies for allegedly conspiring to eliminate competition with respect to billboard locations in Southern California, reducing rents paid by billboard companies to property owners.[29]

D. Transportation and travel sector

Abuses of dominant positions of market power by travel agencies and by the national airline have been cause for concern in a number of cases in the Federal Republic of Germany. In 1976, the largest all-inclusive tour operator in the Federal Republic of Germany[30] was accused of predatory pricing against a specialized tourist agency, aiming at excluding the latter from the market. In 1982, Deutsche Lufthansa, the national air carrier was prohibited[31] from taking over f.i.r.s.t. a grouping of 21 travel agents, which would have strengthened Lufthansa's market-dominating position in the all-inclusive air tour services. In 1985, the Federal Cartel Office[32] objected to anti-competitive tying arrangements by Deutsche Lufthansa AG, and to abuses by the biggest potential purchaser of all-inclusive tour flights, Touristik Union International (TUI) in its bonus-granting policy. There have also been reports in the press that Canadian travel agents have threatened to boycott hotels which circumvent their services to deal directly with tour operators.[33]

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[27] *Ibid.*, para. 124.

[28] *Ibid.*.

[29] United States Department of Justice, press release AT 202-633-2016 of 12 December 1988.

[30] *Annual Reports on Competition Policy in OECD member countries*, Paris, 1976 No.2, pp. 16-17.

[31] *Ibid.*, 1982/2, p. 25, Paris, 1983.

[32] *Competition Policy in OECD Countries, 1985-1985* (Paris, OECD, 1987), p. 108.

[33] See "Travel Marketing by a British Firm Raises Canadian Row", *Wall Street Journal*, 22 November 1989.

The air transport industry was also alleged to have used predatory pricing practices, leading to the bankruptcy of the charter transporter Laker Airways in suits brought in the United States against, *inter alia*, British Airways, British Caledonian, Lufthansa, Swissair, Pan American, and Trans World Airlines in 1983.[34]

Computerized reservation systems (CRSs) are one way in which domininant positions of market power can arise. In the early 1980s, in the United States, anti-competitive practices related to the operation of airline-controlled CRSs attracted the attention of the Civil Aeronautics Board (CAB) and the Department of Justice. The CAB identified a series of anti-competitive practices such as "display bias" in favour of the host carrier, denial of "co-host" status to competitors, delaying the updating of the flight information of competitors, etc. In 1984 CAB issued regulations under its power to prohibit "unfair or deceptive methods of competition in air transportation" to eliminate many of the anti-competitive practices.[35]

A more recent case concerns the EC Commission's intervention against the Belgian airline Sabena which had denied London European Airways (United Kingdom) access to its computer reservation system called Saphir. Sabena's conduct was viewed by the Commission as a means of exerting pressure on London European to artificially increase fares and was thus found to be incompatible with a system of free competition. Secondly, since Sabena's refusal of access could have resulted in London European abandoning its plans to operate between Luton and Brussels, Sabena's conduct could be viewed as a desire to limit production, markets or technical development, to the prejudice of consumers. Thirdly, Sabena's attempt to condition the access to Saphir on the provision of a ground-handling contract was seen by the Commission as clearly constituting an anti-competitive practice. After the Commission imposed a fine of ECU 100,000, Sabena abandoned its refusal to deal vis-à-vis the British company.[36]

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[34] *BNA, Antitrust and Trade Regulations Report*, Vol. 45, No. 1142, of 1 December 1983.

[35] See J.R. Mietus Jr., "European Community Regulation of Airline Computer Reservation Systems", *Law Policy and International Business*, Vol. 21, No. 1 (1989).

[36] Commission decision of 4 November 1988 (IV/32.318 London European-Sabena) (88/589/EEC) in *Official Journal of the European Communities* No. L 317 of 24 November 1988.

Two regulations passed in 1987, specified the applicability of EC competition laws to the air transport sector. Regulation 3975/87 formed a package of interrelated measures adopted by the council as a first step towards completing an internal market in transport.[37] Regulation 3976/87 enables the Commission to grant block exemptions from the provisions of article 85(1) of the Treaty of Rome for a limited period of time to certain categories of agreements, decisions and concerted practices, which have as their aim one of the objectives specified by the regulation.[38] These include: (a) joint planning and co-ordination of the capacity to be provided in scheduled air services, (b) sharing of revenue if the transfer does not exceed one per cent of the poolable revenue earned on a particular route by the transferring partner, (c) consultations for common preparation of proposals on tariffs, (d) slot allocation at airports and airport scheduling, etc. Since then, there have been a number of cases where such exemption has been claimed by joint venture agreements between airlines. These include agreements between Air France and Iberia relating to Paris Bilbao Santiago de Compostela route, Between British Midalnd Airways and Sabena relating to a service between Birmingham and Brussels, and several similar agreements.[39] It is arguable that the granting of such block exemptions can stand in the way of effectively dealing with anti-competitive practices in air transport. In 1989, there have been proposals to amend Regulation 3976/87, by removing revenue sharing from the list of objectives enabling exemption.[40] It has also been proposed that the provisions of Regulation 3975/87 be extended to cover not only air transport between member States but also between a member State and a third party or within a member State.[41]

The EEC has recently adopted a Council Regulation on a code of conduct for computerized reservation systems[42] which clearly recognizes that abuses in the form of denial of access to CRSs, discrimination in the provision, loading and display of data, or unreasonable conditions imposed on participants, can result in serious disadvantages to carriers, travel agents and consumers. The resolution, in particular, obliges those responsible for the operation or marketing of a computerized reservation system to allow any air carrier the opportunity to participate on an equal and non-discriminatory basis in these facilities, subject to any technical constraints outside the control of the system supplier. The latter is also prohibited from attaching unreasonable conditions to any contract with a participating carrier or to make it a condition of participation in a computerized reservation system that a participating carrier may not at the same time be a participant in another reservation system. Moreover, a participant carrier shall have the right to terminate his contract in a computerized reservation system without penalty on giving notice which need not exceed six months.

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[37] *Official Journal of the EC*, L 374, 31 December 1987, p. 1.

[38] *Ibid.*, p. 10.

[39] *Official Journal of the EC*, C 204, 9 August 1989, pp. 3-13; C 29, 8 February 1990, pp. 3-4.

[40] *Official Journal of the EC*, C 258, 11 November 1989, p. 10.

[41] *Official Journal of the EC*, C 248, 29 September 1989, pp. 7-8.

[42] Council Regulation (EEC) No. 2299/89 of 24 July 1989 on a code of conduct for computerized reservation systems, in *Official Journal of the EC*, No. L 220 of 29 July 1989; see also discussion by A. Bressand "Access to Networks and Services

A noteworthy feature of this Regulation is its reciprocal character. The obligations which require that parent or participating carriers should not link the use of CRS to receipt of commission or other incentives for the sale of tickets or other air transport products, nor require the use of any specific CRS for any sale on issues of tickets for such airline transport products do not apply to carriers of a third country which do not conform to the regulation, nor to CRS controlled by carriers of such third country if the EC parent or participating carrier is not provided equivalent treatment in that country to that provided in the Community.[43]

E. Telecommunications

The European Conference of Postal and Telecommunications Administrations (CEPT) represents the telecommunications administrations of 26 European countries including the 12 EC member States. One of the major functions of the CEPT is the development and adoption of recommendations on the technical, supply and usage conditions for international services. In April 1989, the CEPT revised its

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Trade, the Uruguay Round and Beyond", and R. Grey "1992, Services and the Uruguay Round Negotiations" in UNCTAD, *Trade in Services: Sectoral Issues* (United Nations Publication, UNCTAD ITP 26).

[43] See Grey, *op. cit.*

"Recommendations on the General Principles for the Lease of International Telecommunication Circuits and the Establishment of Private International Networks." This revision involved the imposition of a 30 per cent surcharge (or an access charge) where third party traffic is carried out on an international leased circuit or if such a circuit is connected to a public telecom network. It also provided for the application of uniform tariff coefficients for determining the price of international circuits. The EC Commission, after receiving two complaints against the revision, investigated the matter and found that the recommendation amounted to a price agreement and that it restricts price competition, thereby infringing article 85(1) of the Treaty of Rome.[44]

In May 1990, the Commission also initiated an inquiry into the activities of the 160 member International Consultative Commitee on Telephone and Telegraph (CCITT). The CCITT defines the accounting system and tariff structures according to which the PTTs in various countries set their prices and by which members share the costs and profits of long-distance calls between countries of origin and destination of calls. The EC Commission's inquiry aims to determine whether this arrangement constitutes a pricing cartel.[45]

In the United Kingdom, an inquiry has been under way by the Office of Telecommunications (OFTEL) on the pricing of international telephone calls.[46] This inquiry was disclosed following media reports that telephone users were overcharged by more than $10 billion annually due to the operation of an international cartel among large telephone companies. A unilateral cut in the price of international calls by any one country can adversely affect its balance-of-payments. In 1988, OFTEL also reviewed the prices of British Telecom which continues to enjoy a strongly dominant position in the market for international calls in Britain. Even though the OFTEL did not impose any control measures, it warned that such measures would be considered if there is evidence of abuse of DPMP.

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[44] *ATRR*, Vol. 58, No. 1447 (1 April 1990), p. 22.

[45] *ATRR*, Vol. 58, No. 1467 (24 May 1990), p. 814.

[46] *ATRR*, Vol. 58, No. 1462 (19 April 1990), p. 604.

F. Other services

Preliminary studies with respect to the possibilities of developing countries developing their domestic service sector and expanding their export capacity in professional and business services have indicated the presence of certain anti-competitive practices on the part of TNCs which may be hindering developing countries in this respect. These include prohibitions on branches seeking export business, corporate policies to acquire local firms so as to eliminate competition, refusal to use local services, restricting or providing only limited access to distribution systems.[47]

Another set of issues is posed by the conflict of interests between host countries and the attempts within transnational enterprises to eliminate competition between branches and therefore to lower the ability of any country except the headquarter country to achieve significant export earnings. Some TNCs try to ensure an adequate client base for branches and to free their internal resources from the need to "compete" with other branches in order to be able to enhance the range of products through cross-subsidization, thus maintaining market dominance. The attempts of firms to act as "export cartels" in relation to their own branches also results in a lowering of export earnings for the host country and in an increase of market concentration within the local market. In the context of trade liberalization, it is mainly the home countries (usually developed countries) that benefit from the multiplier effects of exporting. As a result, the expected benefits of liberalization for developing countries may not materialize. The central the issue concerns the degree of competition allowed to prevail in actual practice within markets where TNCs are dominant players. This has promoted host-country governments to enact export performance requirements.

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[47] See Thierry Noyelle, "The Growth and Internationalization of Computer Software and Service Industries in Five Developing Asian Countries", in UNCTAD, *Services in Asia*, forthcoming.

V. COMPETITION AND THE INTERNATIONALIZATION OF MARKETS

It would seem likely that the examples of RBPs described above are not confined to the domestic markets of industrialized countries but are applied in international trade in general, and may serve to frustrate efforts to establish a more competitive trading environment. The progressive liberalization of trade in services could have the effect of tempting entreprises in domestic markets to use RBPs to maintain their traditional markets against foreign competitors. As a result, access to certain markets might be made difficult for outsiders to penetrate specific regions or markets where cartels or other anti-competitive arrangements may serve to entrench local companies.

The high degree of concentration of ownership and market power in the services sectors would seem to make the possibility of anti-competitive practices in this area even more likely. While such concentration does not necessarily imply lack of competition among these large enterprises, there is strong evidence to the contrary in certain sectors. There is also evidence that such concentration in itself and the practices of these enterprises present strong barriers to new entrants to the market from developing countries and may discourage exports from developing countries.

Progressive liberalization of trade in services is intended to enable service enterprises operating mainly in domestic markets to expand on a larger and wider scale. However, in international markets national competition laws may not be sufficient to control anti-competitive practices in an effective manner. Domestic RBP legislation, limited to the national territory, will become a less effective mechanism to deal with the practices of enterprises increasingly operating on a global basis. Such enterprises might take advantage of the discrepancies between existing domestic RBP laws and the inevitable loopholes which exist between the legislation of different countries. Governments may also act to shield their national enterprises from foreign anti-trust action.[48] In fact, it should be noted that for some services - such as consulting or engineering research activities which, by nature, are more difficult to quantify and compare with those offered by competitors - RBPs are likely to be more easily used, for example in large and complex projects involving tendering procedures, services associated with the supply of technology and sophisticated machinery, etc.

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[48] See, for example, "blocking statutes" limiting extraterritorial reach of antitrust laws

Studies at the national and regional levels[49] have indicated that liberalization of trade and investment in services, combined with advances in information and communication technology, have tended toward concentration of ownership in services which has often resulted in geographical concentration as well.[50] At the international level, in the absence of disciplines to ensure competition along the lines of that which exists in the EC, there is a danger that deregulation of services and liberalization of market access could result in market sharing arrangements by large corporate entities through the use of anti-competitive practices. The liberalization of trade in services could lead to a situation in which those enterprises with the largest market power, i.e. those already well-established in the bigger markets, will be able to exclude new entrants, and result in a further concentration of market power on a world-wide scale. Thus, a serious effort will have to be made by the international community to ensure that world trade in services remains competitive (i.e. that smaller-scale firms and new entrants are always able to participate in those markets), and that the expected gains from liberalization are achieved.

Given the strategic role of services, in the production/distribution chain, any distortion in the functioning of services markets is likely to have damaging consequences for many other markets. In particular, anti-competitive practices in producer services will affect those producers for whom the services affected by such practices are strategic inputs. The changing nature of corporate structures resulting from technological advance and regulatory changes may result in corporate behaviour

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in some countries such as Australia's Foreign Antitrust Judgements (Restriction of Enforcement) Act, 1979, and the United Kingdom's Protection of Trade Interests Act, 1980.

[49] See the findings of the "FAST Programme" quoted in the *Services in the World Economy* (United Nations Publication, No. UNCTAD/TDR/8 Offprint), pp. 147-148.

[50] See ITP/26, *op. cit.*, as well as TD/B/1241.

which, on the one hand, could result in RBPs assuming forms that are more difficult to both define and detect and, on the other, in the emergence of a series of corporate practices which could result in negative effects on national policy objectives and development programmes and call for new forms of regulation at the national and international level.

In many countries applying competition legislation, the notion of restrictive business practices implies the existence of an intent to distort the rules of normal competition. This element of intent, however, may not necessarily be relevant in the specific context of services, particularly services transmitted through information networks. For example, the policy of centralizing the location of data resources could not be in itself considered as a RBP, although it would obviously have a detrimental effect on developing countries wishing to strengthen their information resources. Enterprises may seek to consolidate their positions in face of intensified international competition, through the use of various devices which often may not take the form of the "classical" RBPs described in the preceding paragraphs, but which may involve the use of information networks and distribution channels to create "captive markets" and "captive suppliers", by rendering it difficult for clients to change suppliers and by locking in upstream suppliers. Such strategies may have the effect of creating insurmountable barriers to new entrants in the market, but not constitute RBPs in the sense defined in most national competition laws. The reaction of governments to the practices of the computerized reservation systems described above[51] is probably a forerunner of future dilemmas in differentiating legitimate networking strategies from RBPs. As has been pointed out by certain authors, the phenomenon of networking has made it more difficult for governments to "deliver" on access commitments, as access to networks lies mainly in the hands of the private sector.

The frontier between legitimate "networking" operations and anti-competitive practices is sometimes difficult to establish. As the CRS experience has demonstrated, information technologies can create the need for new types of anti-competition laws.[52] As noted above, some corporate objectives may seem incompatible with national objectives of developing countries. While some developing countries tend to consider information as a "natural resource" and information networks as a "common infrastructure", corporations would view information as proprietary in character, losing its value if generally diffused. Therefore, international exchange of information services calls for a broader vision of which trade practices can be considered as "anticompetitive". As transfer of technology provisions have been identified as an inherent component of a multilateral framework for trade in services that would be acceptable to developing countries, the RBPs related to technology control identified above are relevant in this context.

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[51] For example, American Airlines has filed an unfair competition complaint against Iberia for *withdrawing* from AA's Sabre CRS system. See *Financial Times,* 21 March 1990.

[52] For example, the EC Regulation on CRS described above.

In the context of liberalization of trade in services, the discrepancies that exist between the competition laws of various countries pose a serious problem, such as unevenness of the scope of anti-trust policies of trading partners. In the telecommunications sector, the EC sources have identified as one of the Community's objectives in the Uruguay Round, the securing of adequate opportunities for consultation, investigation and redress if the Community operators consider that their interests are prejudiced by the abuse of DPMP in global information and communication markets. Another similar problem in this sector concerns the use of different proprietary standards in ceratin markets, which exist independently of international standards. The prevalence of such standards can limit competition and in effect deny market access to services from outside, even if apparently the market might seem liberal. The question of proprietary standards needs to be addressed by a framework agreement on services, if it is to prevent this from operating as a barrier to undistorted trade in services.

The intrinsic characteristics of services, in particular the type of relationship they imply between producers and customers of a generally non-storable item, make RBPs more difficult to track and define in services than in other sectors. In the specific case of information intensive services, the nature of the product is such that natural monopolies or dominant positions of market power appear, thus creating a "restrictive" environment in some service markets without necessarily an "intent" by, or conspiracy among, any company (or companies) to distort normal competition.

VI. IMPLICATIONS FOR THE URUGUAY ROUND NEGOTIATIONS ON TRADE IN SERVICES

In the Group of Negotiations on Services in the Uruguay Round, the submissions made by some countries attempt to address the question of anti-competitive practices. Among the developed countries, Switzerland has suggested that parties to a multilateral agreement on services should require, in accordance with their own competition laws and with relevant international rules and principles, enterprises operating in their territory to refrain from (a) taking action that abuses a DPMP and adversely affects competition, and (b) participating or strengtheining the restrictive practices of cartels or other agreements that adversely affect or eliminate competition. The Swiss submission also suggests that when monopolies or exclusive providers of a service compete in the provision of another service, they should not use their monopoly position to engage in anti-competitive practices that adversely affect the service providers of another country. The proposal by the European Community includes provisions for access to information from service providers of foreign origin providing services within the jurisdiction of a country, in order to prevent concerted practices and abuses of DPMP. The EC submission specifies that such requests for information should not exceed that which would be made in similar circumstances from domestic service providers. In addition to this, statistical information may be requested, provided that such requests are not more onerous than similar requirements in the foreign firm's home country. However, neither of these proposals appear to argue for a multilateral regime for the control of anti-competitive practices. As noted earlier, in the area of trade in services, leaving measures entirely to the national competition laws of individual countries will be inadequate for effectively ensuring competition in international trade in services. This is particularly the case of sectors where dominant positions of market power arise from the nature of the service provided.

At the GNS, developing countries have stressed the need to ensure in any multilateral framework that anti-competitive practices of enterprises do not serve to nullify the beneficial results of the progressive liberalization of services trade, by undermining the expected efficiency gains or creating barriers to market entry to developing-country firms, and thus, that any efforts to liberalize trade in services will have to address competition law aspects.

Action at the multilateral level to control RBPs could address:

- traditional forms of RBPs;
- RBPs related to the control of technology;
- dumping; and
- the use of "networking" to restrict access, and to create captive suppliers and clients.

In addition, many of the RBPs affecting trade in goods also relate to services, i.e. distribution systems.

Developing countries have put forward a number of proposals in the GNS for a multilateral framework on trade in services, the essence of which, as they relate to anti-competitive practices is described in the following paragraphs.

The provisions on transparency are central to the detection of RBPs and other anti-competitive practices, calling for action at the national and multilateral levels. The draft elements submitted by developing countries suggest that nothing in the framework should prevent the application of national laws and regulations requiring the provision of information by economic operators within the jurisdiction of a signatory for statistical and other purposes, with due respect to the privacy and confidentiality of the data and information provided.

Such proposals also recognize that the charaterisitics of anti-competitve practices in the services sector as described in the preceding paragraphs would, however, dictate in favour of action at the mutliateral level. Developing countries may not have the means of detecting such practices nor for dealing effectively with the practices of large foreign corporations which may be not only adversely affecting competition in the service sector in the national market but also acting as a barrier to national firms in entering world markets. It has been proposed that the enquiry points to be established by each signatory would provide information of corporate activities, and a multilateral obligation to this effect has been proposed by several developing countries. This entails that transparency requirements shall be applied to ensure that the objective of the framework is accomplished or, in other words, that there would be an obligation on all signatories to impose such requirements and to make relevant information available through the enquiry points. It has been proposed in the joint proposals submitted by developing countries to the GNS that transparency could be made a condition of market access.

Another objective of a framework agreement will be to ensure, on the one hand, that competiton legislation is not used as a device to harass foreign suppliers and thus frustrate the accomplishment of the objectives of the framework, and on the other, that concessions negotiated within the framework auspices could not serve to hinder the legitimate application of competition law. Developing countries have proposed that safeguard measures could also be applied in order to deal with adverse trade effects caused by situation of concentration of ownership, market domination and restrictive business practices. Furthermore, they have argued that nothing in the framework should interfere with the signatories rights to apply or adopt non-discriminatory laws to prevent abuses by economic operators engaging in unfair practices to the prejudice of other service producers and or consumers or by creating market distortions through the obstruction of competition.

In the area of trade in goods, a wide range of investment measures have been found necessary by host countries, both developed and developing, in order to compensate for the effect of distortion arising from the practices and behaviour of the TNCs. Developing countries obviously find it preferable to impose certain conditions on the foreign investor to ensure that the firm's behaviour conforms to the national development objectives and pre-empts possible anti-competitive behaviour, rather than attempt to identify such practices and prosecute the foreign firms once they are established in the country. Similar measures might be even more necessary with respect to trade in services, particularly where movements of capital are involved, and where trade is effected through franchises or similar mechanisms or through international corporate or intercorporate networks. Failure to address anti-competitive behaviour within the overall multilateral framework would inevitably lead to an intensification of such unilateral measures with respect to services at the national level.

There is concern, however, that improved information and permissive provisions guaranteeing national sovereignty in this area may not suffice in that developing countries would not be in a position to discipline large foreign corporations, particularly with respect to activities outside their frontiers. It is difficult, for example, to imagine that smaller developing countries could, within the context of domestic competition legislation, effectively deal with many of the anti-competitive practices described above, such as the operations of CRSs, restrictions on access to distribution systems, etc. For this reason, developing countries have proposed that the framework shall have provisions to deal with the adverse effects of restrictive business practices and/or that signatories shall undertake a commitment to control and discipline their national service suppliers who have engaged in restrictive business practices. The proposals submitted by developing countries to the GNS would include an obligation on parties to the framework to (i) develop international standards and disciplines for the control of anti-competitive service suppliers behaviour, and (ii) endeavor to agree upon multilateral disciplines and enforcement mechanisms in respect of these standards.

As can be seen from the description above of the debate related to the application of the Set of Principles and Rules, developed countries have firmly resisted any suggestion that their governments should take actions to discipline the activities of "their" enterprises abroad. However, the adoption of the framework for trade in services, in the shape in which it seems to be evolving, would create an entirely new situation from the point of view of the extent and balance of rights and obligations. If the framework is to provide for the negotiation of concessions with respect to the "presence" of foreign enterprises in importing countries, and to establish certain principles outlining the rights of such foreign firms, then the argument that the practices of such enterprises abroad fall outside the reponsibility of the "home" countries would seem to lose most of its validity. Assuming criteria for determining the origin of firms can be worked out, signatories would acquire, through negotiations, the right to intervene diplomatically with importing-country governments (i.e. through consultations and/or dispute settlement mechanisms) with respect to the manner in which "their" corporations are being treated by the importing countries. It would thus seem that the maintenance of an equitable balance of rights and obligations would require that the importing country could also intervene with the "home" country with respect to the activities of "its" corporations.

In order to deal with this situation, signatories could agree to avoid encouraging anti-competitive practices, to act against such practices and to refrain from adopting policies which permitted anti-competitve practices for export but not for domestic commerce. Provisions might also be included to the effect that in instances where behaviour of a particular firm or firms was resulting in barriers to market entry which could not be dealt with under national laws, remedial action at the mutlilateral level could be pursued under the dispute settlement mechanism. There might also be a need to address the reciprocal aspects of RBPs, i.e. where domestic RBPs provisions would not apply with respect to countries which did not implement comparable provisions (e.g. the EC Regulation on CRS).

The question whether provisions for dealing with dumping practices in trade in services should be included in the framework, has also been raised. Certain countries have begun to introduce competition legislation to deal with unfair trade practices in trade in services comparable to anti-dumping and countervailing duty legislation on goods trade.[53] There is concern that anti-dumping measures in the services sector could provide a potential mechanism for the harassment of legitimate trade as has been done in the goods sector. The situation could be even more serious in services sectors, given the difficulty in identifying such concepts as "unfair market price" in a sector where quality considerations, "networking" and "packaging" are prevalent, and where it is difficult to calculate a unit price and statistics are generally inadequate.[54] It is the view of certain experts in this area that the introduction of anti-dumping provisions analogous to article VI of the General Agreement and the GATT Anti-Dumping Code, could open the way to even greater abuse of such provisions as a means of harassing legitimate trade than that experienced in the goods sector,[55] and consequently that it might be preferable to consider dumping of services as an RBP to be dealt with primarily by actions under the responsibility of the exporting country, in order to reduce the potential restrictive effect of the resort to anti-dumping action on the import of services.

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[53] One example is the EEC in the area of shipping. See J. Bellis, E Vermulls and P. Musgrave, "The New EC Regulation on Unfair Pricing Practices in Maritime Transport: A Forerunner of the Extension of Unfair Trade Concepts to Services?", *Journal of World Trade*, February 1989.

[54] See Grey, "Concepts of Trade Diplomacy and Trade in Services", Thames Essay, No. 56 (London, Trade Policy Research Centre Gower, 1989), where it is argued that the introduction of "anti-dumping and countervailing duty" type approaches

The preceding paragraphs have outlined the rationale behind and described the need for including provisions to deal with RBPs and other anti-competitive practices on a multilateral basis within the framework, the essential objective being to ensure that the framework would deal in an equally stringent manner with distortions to trade in services caused by the actions of private operators as with those of governments, and that all signatories to the framework assume meaningful responsibility in assuring that this objective is attained.

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would inevitably lead to increased restrictions on trade in services and constitute a "retrograde" step, and that a preferred approach would be for governments to undertake greater commitments to dissuade their firms from RBPs, dumping and other unfair practices abroad. Given the extent to whcih services are already regulated, such an approach would seem more feasible for services than for goods.

[55] *Ibid.*

NOTES ON A POSSIBLE MULTILATERAL FRAMEWORK FOR INTERNATIONAL TRADE IN BANKING SERVICES

Andrew J. Cornford[*]

INTRODUCTION

So numerous are the interactions between real and financial activities in most types of economic system that pivotal importance is generally attributed to the sector which provides banking services. Not only are a great many transactions between economic agents linked to the use of some or more of such services, but the very pervasiveness of this connection also means that the banking sector can be a powerful instrument for controlling or influencing the character and scale of production. This potential and the large number of different banking services make the establishment of norms and regulations in this field a particularly complex matter. This statement applies alike to national regulatory regimes and to agreements about norms at an international level. The notes which follow are in no way exhaustive. They are designed to throw light on various subjects which seem relevant to the North-South dimension of current multilateral negotiations that may lead to an agreed international framework for trade in banking services. As such, the notes treat only incidentally aspects of such a framework of primary concern only to developed market-economy countries participating in the negotiations.

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[*] The author is a member of the UNCTAD secretariat.

I. DEFINITION AND MEASUREMENT

A. The scope of banking services

For the purpose of these notes the definition of banking services in a recent OECD study is appropriate, namely "all financial services and related ancillary services that may be offered by financial institutions such as banks, savings banks, securities firms, brokers and other providers of financial services including non-financial enterprises."[1] Various classifications of banking services by major category and by sub-categories are possible. For example, a classification focusing on major functional categories might distinguish between payment services, facilities for holding liquidity reserves and financial savings and investments, facilities and instruments for borrowing, trading facilities for marketable financial instruments, brokerage facilities for buying and selling financial instruments, investment services for private individuals and institutional investors, special financial services for industrial and commercial enterprises, and miscellaneous finance-related services such as insurance, real-estate and commodity brokerage, tax advice and safe-custody services.[2] Another broader set of major categories sometimes used distinguishes between retail banking, wholesale banking, securities-related services, interbank services and international financial services.

Each major category in such classifications comprises several sub-categories. Thus, for example, international financial services include taking deposits from non-residents, traditional services associated with financing and payments in international trade, international lending not closely linked to particular international transactions, various services associated with international dealing in securities, buying and selling foreign exchange, and services associated with the provision of instruments (such as futures and options) for managing the risks of positions in foreign exchange and other financial assets.

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[1] G. Broker, *Competition in Banking* (Paris, OECD, 1989), p. 105. This definition excludes insurance underwriting but not services of insurance brokerage provided by the financial institutions mentioned in the main text.

[2] *Ibid.*, pp. 107-8.

These definitions serve to bring out the important point that banking services are provided through many different sub-markets differentiated by product, by type of customer and supplying institution, and by territorial boundaries. The set of sub-markets in any given country is determined by various features of its history, geography and economic development. Thus, for example, many aspects of the availability of a country's financial services, including the modalities of their provision, reflect the influence of its legal and regulatory framework. In view of this connection between a country's particularities and the character of its financial system, it is not surprising that the various sub-markets for financial services manifest considerable differences among countries, and that some services are largely or completely absent in many countries. For example, several services such as those associated with dealing in securities or with credit cards are used by only a restricted number of people and enterprises in most low-income countries, and many of the services associated with the management of financial risk (such as forward-exchange markets, futures and options) are frequently of negligible significance in such countries.

The multiplicity of sub-markets constituting banking systems, and the variations among countries in the ways in which banking services are provided and regulated both bear importantly on the possible contents of an agreement on an international framework for trade in such services. Differences between sub-markets mean that for many purposes, including several relevant to such an agreement, particular banking activities need to be considered separately. It is true that a major objective of such an agreement would be to achieve greater uniformity in several aspects of the ways in which banking services are regulated in different countries. However, the effort in this direction would need to be balanced by a flexibility taking due account of differences among countries in levels of development, in geography, in the philosophy and modalities of economic policy, etc.

B. The meaning of international trade in banking services

The definition of international trade in banking (and other) services has been the subject of much debate. For the purpose of an agreed international framework for such trade, the most important issue in this debate has been whether to include not only service transactions between the residents of a territory and non-residents, but also services provided by foreign-owned branches, subsidiaries and affiliates. Thus a more restrictive definition would limit trade in services to "international transactions in services between the residents of one country and the residents of another country irrespective of where the transaction takes place".[3] Under the accepted balance-of-payments definition the concept "non-resident" applies to economic agents whose presence in the economy of a territory is temporary and associated with a specific purpose.[4] Such a definition would not include the branches, subsidiaries and affiliates of foreign-owned enterprises since their presence is not temporary. In consequence it would exclude several types of banking service that are difficult to provide to residents without a long-term physical presence in a territory. Yet among these services are those in which the major proponents of an agreed international framework are primarily interested. Thus an alternative definition would extend international trade in banking services to cover resident suppliers owned abroad.[5]

At the current multilateral negotiations on trade in services, final agreement on definition has yet to be reached. The document setting out the results adopted by the Trade Negotiations Committee at its mid-term review states that "Work on definition should proceed on the basis that the multilateral framework may include trade in services involving cross-border movement of services, cross-border movement of consumers, and cross-border movement of factors of production where such movement is essential to suppliers." Certain of the concepts considered by the Committee to be relevant in the context of the elaboration of a multilateral framework (such as national treatment, market access and the regulatory situation) seem especially pertinent to cases where international transactions in services are associated with a long-term presence on the spot.

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[3] "Towards a possible multilateral framework for trade in services: some issues and concepts" - report prepared by Deepak Nayyar at the request of the UNCTAD secretariat (UNCTAD ITP 17), para. 5.

[4] *Ibid.*, para. 8, and IMF, *Balance-of-Payments Manual,* Fourth Edition (Washington, D.C., IMF, 1977), paras. 59-66.

[5] Concerning the use of the concepts "location" and "ownership", in this context see also *Production and Trade in Services: Policies and their Underlying Factors Bearing Upon International Services Transactions* (United Nations Publication, Sales No. E.84.II.D.2), paras. 100-101.

The sequel focuses mainly on services supplied by foreign-owned banking units present in a territory. The lesser attention given to transactions between residents and non-residents reflects partly the emphasis of recent discussion. But it is also due to the difficulty of abstracting issues under this heading from the separate but related question of foreign exchange control. Several of the major categories of financial transaction between residents and non-residents (such as borrowing from foreign banks, the buying and selling of foreign securities and other financial instruments, and the servicing of external debts) are widely subject to such control in developing countries. However, policies in this area involve questions of macro-economic management that transcend trade in banking services. Moreover, foreign exchange control is a subject covered by the IMF Articles of Agreement. Considerations such as these may complicate agreement on a framework for trade in banking services that includes developing as well as developed countries. However, a full explanation of the implications of the many connections between such trade and foreign exchange control is beyond the scope of these notes (although there are references to the topic at various points).

C. Measuring international trade in banking services

Perhaps the most appropriate measure of international trade in banking services is the value added of the activities chosen for inclusion in the definition of such trade. This measure differs from the gross-output concept used for trade in goods, and has the advantage of avoiding the problem of defining the gross output of the banking sector. However, it still presents serious difficulties. Current methods of measuring the contribution of banking services at a national level to GNP or GDP are still widely regarded as unsatisfactory in certain respects.[6] One source of this dissatisfaction concerns the treatment of sales of banking services to non-residents. Unless appropriately adjusted on an *ad hoc* basis, current methods take no account of the contribution of such sales to GNP/GDP.[7] With the growth of international banking and the spread of offshore banking centres, the distortion due to this omission has increased in importance. In the extreme case of Luxembourg it resulted by the late 1970s in an underestimate of the territory's GDP amounting to about 25 per cent.[8]

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[6] This apparent paradox of current methods, which reflects such difficulties as that of allocating the interest payments of non-financial enterprises between financial intermediaries on the one hand and other sources of capital on the other, is explained in the summary of the current approach to the treatment of banking services in national accounts in P. Host-Madsen, *Macroeconomic Accounts: An Overview*, Pamphlet Series No. 29 (Washington, D.C., IMF, 1979), pp. 33-35.

These difficulties bear on the possibility of measuring international trade in banking services according to the narrower of the two definitions discussed under B.2 above, namely, international transactions in such services between residents and non-residents. It would appear that such figures are not in general readily available from national accounts. They could be estimated from information concerning charges on banks' business with non-residents, the margins between lending and borrowing rates of interest on their loans to non-residents, etc. But the establishment of uniform guidelines for estimates on this basis would require an international initiative.

Once estimates of international trade in services under the narrower definition of such trade were available, measurement which includes also the value added of banking units established in foreign countries should not involve any insuperable problems in principle. Estimates of this value added could be made from data for the income of such units from their charges and interest-rate margins.[9]

Several statistics are frequently cited to give an idea of the recent growth of different categories of international banking business. Although these statistics are typically values of assets, liabilities or transactions and are thus not measures of trade in financial services according to either of the definitions discussed in these notes, they do give useful indications of recent trends. Thus, for example, the annual average rate of growth of the external assets in dollars (after adjustment for movements in exchange rates) of the deposit money banks of OECD countries was 22 per cent in 1960-1970, 23 per cent in 1970-1980, and 15 per cent in 1980-1985. The number of foreign branches of the Federal Reserve member banks of the United States rose from 131 in 1960 to 532 in 1970 and 916 in 1985, while the corresponding figures for the branches and subsidiaries of Japanese banks were 37 in 1960, 67 in 1970 and 346 in 1985. Several types of financial transaction (which are frequently vehicles for international transactions in banking services) have also recently manifested very rapid rates of expansion. For example, the transactions in foreign securities of the residents of four major OECD countries increased at an average annual rate of 67 per cent in 1980-1986, and for the transactions of non-residents in the domestic securities of the same countries during this period the average annual rate of growth was 53 per cent.[10] Similarly high rates of expansion have also characterized during extended recent periods transactions in categories of futures and options that are relevant in the context of international trade in banking services.[11]

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[7] H.W. Arndt, "Measuring trade in financial services", *Banca Nazionale del Lavoro Quarterly Review*, June 1984, pp. 204-12.

[8] *Ibid.*, p. 207. In several other OECD countries claims on non-residents represent substantial proportions of banks' total assets. For estimates for the end of 1982 see R.C. Bryant, *International Financial Intermediation* (Washington, D.C., The Brookings Institution, 1987), tables 2-3.

[9] Estimates of net income from international activities are available for the largest United States banks. See, for example, J.V. Houpt, "International trends for U.S. banks and banking markets", *Staff Study 156, Board of Governors of the Federal Reserve System* (Washington, D.C., May 1988), table 14.

II. BEHIND THE THRUST FOR AN INTERNATIONAL AGREEMENT

The impetus for an agreement on a framework for international trade in services comes mainly from certain OECD countries. Prominent among proponents of such an agreement are transnational enterprises, a particularly important role here being played by transnational banks. The objectives of these proponents concern markets both in each other's home countries and in developing countries. The objectives concerning the first set of markets need to be seen in the context of efforts also under way in other fora to achieve a more uniform competitive regime for banks throughout the OECD area, and are not discussed in these notes. Those related to markets in developing countries spring from a perception among suppliers of several major categories of services (including banking) in OECD countries that, as a group, they possess a competitive edge vis-à-vis their counterparts in the rest of the world. Although there are services in which suppliers in some developing countries have already manifested international competitiveness, as regards the financial sector there can be no doubt that banks in the OECD area do have a competitive edge in many sub-markets.[12] The edge is based on such factors as wider mastery of banking technique and relevant advanced technology, economies of scope,[13] superior access to information and to currencies widely used in international trade, greater capacity for innovation, and stronger links to suppliers of other supporting services for international trade such as insurance and shipping.[14]

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[10] Broker, *op. cit.*, tables 6.2, 6.3 and 6.6.

[11] See, for example, J. Walmsley, *The New Financial Instruments: An Investor's Guide* (New York, John Wiley and Sons, 1988), tables 6.2 and 8.1, and R.E. Fink and R.B. Feduniak, *Futures Trading: Concepts and Strategies* (New York, New York Institute of Finance, 1988), figs. 1-5 and 25-6.

The increasing importance of services to the transnational enterprises of major OECD countries in their relations with developing countries is evident in statistics showing recent sectoral trends in foreign direct investment. Thus, for example, according to statistics in a recent study of the United Nations Centre on Transnational Corporations, the share of services in outflows of foreign direct investment from seven OECD countries to developing countries rose from 48 per cent in 1981-1983 to 65 per cent in 1984-1987.[15] This rise represents the continuation of a trend observable for the majority of these and certain other OECD countries over a longer period.[16] A more disaggregated breakdown showing the recent trend in the share of financial services in outflows of foreign direct investment is available only for five of the above-mentioned countries to all destinations (including developed market-economy countries), and in three cases the figures for insurance are not separated from those for banking. For each of the five countries the growth of outflows of foreign direct investment in banking or in banking and insurance matched or exceeded the growth for services as a whole.[17]

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[12] For discussion of the export performance and potential of developing countries in banking, insurance, tourism and travel, maritime transport, construction and engineering services, professional services, and information, computer and communications services see OECD, *Trade in Services and Developing Countries* (Paris, OECD, 1989), Part I.B, and (in the case of engineering and construction services) *Trade and Development Report, 1988* (United Nations Publication, Sales No. E.88.II.D.8), Annex 6.

[13] Economies of scope are those which result when goods or services are produced together in one unit rather than in separate ones. More formally, if C is a function representing cost of production, and X and Y are two goods or services subject to economies of scope, $C(X,Y) < C(X) + C(Y)$.

[14] It might be argued that a competitive edge based on superior links to the suppliers of the other supporting services required for international trade are already covered under the first two factors cited in the main text. However, there is a case for drawing separate attention to these links owing to the role which they have played historically in the rise of many of the world's traditional financial centres.

[15] "Recent developments related to transnational corporations and international economic relations" - report of the Secretary-General (E/C.10/1989/2), paras. 12-13 and table 5. (The seven countries are Canada, France, Federal Republic of Germany, Japan, Netherlands, United Kingdom and United States.)

III. BENEFITS AND COSTS OF A MORE LIBERAL REGIME FOR INTERNATIONAL TRADE IN BANKING SERVICES

The benefits claimed for a more liberal regime for international trade in banking services spring mainly from two sources, increased competition and the transfer of skills. Both of the types of international trade in banking services described above, namely that between residents and non-residents and that supplied through units established in foreign markets for the purpose, can bring increased competition. The transfer of skills, on the other hand, will be associated primarily with the latter type of trade.

The extent of the benefits actually achieved by means of the transfer of skills will depend to a great extent on policies in host countries. Such policies need to be taken into account in the elaboration of the concepts, principles and rules agreed upon as relevant to a framework for international trade in services at the mid-term review of the Trade Negotiations Committee. Among these concepts, principles and rules (which are taken up in section VIII below), those of "market access" and "increasing participation of developing countries" seem particularly appropriate for elaboration that recognizes the importance of this objective.

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[16] *Transnational Corporations in World Development Trends and Prospects* (United Nations Publication, Sales No. E.88.II.A.7), table XXI.2.

[17] *Ibid.*, Annex table C.6. (The countries and periods in this table are as follows: Canada, 1976-1984; Federal Republic of Germany, 1976-1984; Japan, 1977-1985; Netherlands, 1973-1984; and United States, 1977-1985.)

Competition in banking services may involve any of the spectrum of methods for managing financial institutions' assets and liabilities, and may affect any or all of the prices, costs and qualities of such services in different sub-markets. Not all of its manifestations would be generally considered to be socially beneficial, and many of them leave losers as well as gainers. Its favourable effects may include lower rates of interest to borrowers and higher rates to depositors or lenders as a result of increased pressure on profit margins or reductions in costs (or both). Other benefits are the introduction of new services or the improvement of existing ones leading to better satisfaction of the needs of banks' clientele.

The frequently complex ways in which the benefits and costs of change in banking may be interrelated can be illustrated in the case of the emergence of so-called "assets and liabilities management". This term refers to the increasingly structured approach of banks towards managing assets, liabilities and off-balance-sheet business. Banks of course have always had to manage their assets and liabilities, but until recently in most OECD countries their decisions reflected longer-term considerations associated with the relatively stable environment in which they operated. The shift to a more active management stance resulted from various trends such as greater dependence (beginning as early as the 1950s in the United States) on wholesale funds lent by non-financial enterprises with a greater sensitivity to interest rates than traditional retail depositors, higher and more unstable interest and exchange rates since the early 1970s, and widespread financial deregulation and the growth of international banking from the 1960s onwards, of which one consequence was a reduction of the compartmentalization of financial markets and an increase in competition among the different types of institution serving them.[18] Increased risks due to greater fluctuations in interest and exchange rates also stimulated the introduction of new techniques and instruments (such as financial futures) to reduce or offset them.

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[18] This brief account of assets and liabilities management relies heavily on J.S.G. Wilson, *Banking Policy and Structure: A Comparative Analysis* (London, Croom Helm, 1986), pp. 233-60 and Chap. 8; R. Harrington, *Asset and Liability Management by Banks* (Paris, OECD, 1987); and E.W. Reed and E.K. Gill, *Commercial Banking*, 4th edition (Englewood Cliffs, New Jersey, Prentice-Hall, 1989), pp. 152-57.

For depositors and lenders there have been benefits from assets and liabilities management in the form of the higher rates of interest resulting from competition for their money, and of a greater range of financial instruments for the placement of savings and liquidity (for some of which active secondary markets have developed). However, for borrowers the outcome has been less clear-cut. These have benefited from the greater availability of funds and innovation in lending instruments which have accompanied increased competition and financial deregulation. But many borrowers have at the same time had to pay higher rates of interest. Moreover the new techniques and instruments for risk management have in some cases had double-edged effects, and have probably themselves acted as sources of volatility in financial markets.

Thus, for example, lending at variable interest rates by banks facilitated liabilities management by making it possible to reduce or eliminate risks due to differences between borrowing and lending rates of interest. But this result was achieved by shifting the burden of possible rises in interest rates on to borrowers, thus increasing credit risks. Moreover, while new financial instruments such as futures are capable of providing protection against fluctuations in financial variables, protection by this means can be costly and its coverage is not complete. It is also widely believed that the connection between such protection and the tradability of many of the financial instruments in question has led to a situation where the instruments themselves contribute to fluctuations in interest rates and the prices of financial assets. Indeed, in a recent book one banker referred to "the vested interest in instability" of the bulk of participants in financial markets.[19] The consequences of the greater unpredictability of financial variables for economic agents in the rest of the economy are not easy to identify precisely but are potentially quite substantial.[20]

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[19] Fuller quotation of the passage in question may be of some interest. "A more controversial feature of the new shape of the financial system is that the bulk of its participants now have a vested interest in instability. This is because the advent of high-technology dealing rooms has raised the level of fixed costs. High fixed costs imply a high turnover for profitability to be achieved. High turnover tends to occur only when markets are volatile.", Walmsley, *op. cit.*, p. 13.

[20] For a discussion of the various costs of increased financial unpredictability in relation to techniques and instruments for protection against financial risk see *Trade*

Levels of competition vary considerably among the sub-markets for different banking services. At one much-cited extreme is the local market for retail banking services in a village or small town. In such cases competitive pressures are typically low, although the banks in question may not abuse their monopoly positions. These pressures tend to increase in large cities, even in retail banking. They are also greater in the sub-markets for services such as credit cards or those to corporations. In certain areas co-operation among banks is encouraged by the authorities as being more appropriate than competition. Such encouragement, for example, has been evident towards efforts by banks to take advantage of the potential of new technology for the development of more efficient inter-bank payments circuits.

The position in particular sub-markets is in general significantly affected by the level of development of a country. As already mentioned in section I.A, certain banking services do not exist or are available only on a small scale in low-income countries. Moreover, even in the case of retail banking services, both the level of competition and the quality and character of services provided vary substantially between low-income and high-income countries. Indeed, in many low-income countries large parts of the population make no use of banks, depending instead for such financial services as they require on money lenders and other arrangements more or less formal.[21] In situations of this kind it is frequently government policy to increase the number of people making use of banking services with such aims as expanding the degree of monetization of the economy, making possible a more efficient use of savings, and bringing down the cost of credit for those with no alternative to dependence on money lenders. Such a policy may be pursued through mixtures of controls and incentives, and an agreement on a framework for international trade in banking services should provide for flexibility in this regard.[22]

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and Development Report, 1988 (United Nations Publication, Sales No. E.88.II.D.8), chap. II, sections D and E.

[21] For some examples of such arrangements see J.S.G. Wilson, "Building the financial system of a developing country", *Lloyds Bank Review*, No. 93, July 1969, pp. 39-40 and 46-47.

[22] For example, it is an objective of government policy in India to extend banking facilities throughout the country's villages, estimated to number about 575,000. One of the instruments for achieving this objective is an entitlement formula under which the right to open offices in urban areas already having several banks is linked

Foreign banks have in certain instances contributed to the expansion of banking networks in developing countries and to injecting increased competition into the sub-markets for particular banking services.[23] Yet there remain widespread reservations among developing countries as to the desirability of a broad opening-up of their economies to foreign banks. These reservations go beyond concerns about the potential losses from increased competition discussed above, and involve such matters as the use of the banking system for the promotion of a country's development objectives, the possibility that the operations of foreign banks may complicate monetary policy, and more generally the competitive strength and governability of foreign banks.

The first two of these subjects are given separate treatment in sections V and VI below. The third includes a number of issues on which reservations and apprehensions in developing countries are less well defined. Nevertheless, these concerns influence restrictions on the entry and operations of foreign banks and figure in parts of the discussion in section VIII of the concepts, principles and rules relevant to an agreed framework for international trade in banking services. Particularly important in this context is the infant-industry dimension of developing countries' policies towards foreign banks. Underlying infant-industry considerations in this sector is the conviction, which developing countries share with OECD countries, that the banks of the latter have a competitive edge. While in OECD countries this competitive edge is seen as a reason to press for a liberalized regime for international trade in banking services, in developing countries it is seen as a reason for protecting indigenous banking sectors whose expansion is considered to be an integral element of successful development. Finding a balance between these points of view is thus central to the

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to the number of offices opened in rural or semi-urban areas with few or none. Wilson, *Banking Policy and Structure*, pp. 143-44.

[23] The literature on foreign banks' role in developing countries is voluminous, including as it does significant parts of that treating historical economic relations between major developed market-economy countries and their colonies or countries within their traditional spheres of influence. For a recent discussion of issues with which these notes are concerned, such as the role of foreign banks in branch networks, the distribution of their lending by categories of borrower and loan, and comparison of their techniques and management with those of domestic banks, see the case studies of Malaysia and Thailand in *Transnational Banks: Operations, Strategies and their Effects in Developing Countries* (United Nations Publication, Sales No. E.81.II.A.7), chap. I (section C) and chap. IV (sections A-D).

effort to achieve agreement on a framework for international trade in banking services.

The concerns deriving from the size, "transnationality" and competitive strength of foreign banks have in some cases a fairly specific character. For example, there are concerns as to these banks' governability. Issues under this heading with a bearing on the conduct of monetary policy are taken up in section VI. Governability also involves the capacity of transnational banks to use their international networks to evade taxes, to facilitate capital flight, or to conceal aspects of their operations from developing countries' regulatory authorities. Thus governability, for example, is related to the concept "transparency", discussed in section VIII, which covers the exchange of information under an agreed framework for international trade in banking services.

Another apprehension sometimes expressed concerning foreign banks is that their superior strength makes it possible for them to squeeze or stifle indigenous competitors through price discrimination between markets in different countries. Such discrimination would be for international trade in banking services the counterpart of dumping in the case of trade in goods. The possibility of such practices undoubtedly exists. A prerequisite of successful price discrimination is the existence of impediments to arbitrage between the lower-price and higher-price markets.[24] In the case of services the impossibility of storing them is generally cited as preventing arbitrage. As regards many services including those of a bank in different countries, there are also many other obstacles both to acquiring the knowledge about price differentials necessary for arbitrage operations and to carrying them out. Systematic evidence concerning price discrimination by banks is unsurprisingly difficult to obtain. Predatory price discrimination clearly exists only when losses associated with low prices in some markets for the purpose of damaging competitors are subsidized from profits made elsewhere. In other instances both the identification of price discrimination and the demonstration of its connection to unfair competition are much more complex. In all cases of discrimination the relevant information concerning prices and costs is not generally available, and even if it were, its interpretation would be controversial.[25] It can perhaps at most be conjectured that the use by foreign banks of price discrimination as a competitive weapon is unlikely to have been extensive in their retail banking operations in developing countries. But it should not be discounted that such discrimination may sometimes be used in the provision of banking services to businesses, whether domestic or transnational enterprises.

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[24] The susceptibility of services to price discrimination is emphasized in classic discussions of the subject such as those of J.M. Clark, for example, *Studies in the Economics of Overhead Costs* (Chicago, University of Chicago Press, 1923), chap. XX (especially pp. 425-28), and *Social Control of Business*, Second Edition (New York, McGraw-Hill Book Company, 1939), pp. 209 and 350-51.

IV. SOME RELEVANT HISTORICAL EXPERIENCE

There can be little doubt that, in developing countries as elsewhere, attitudes towards foreign banks and beliefs in the desirability of promoting domestic ones have been formed partly in response to historical experience. The many different relevant aspects of such experience are much too extensive to be discussed in these notes. Nevertheless, a little history of international and interregional banking may serve to bring out more clearly reasons why it has been an objective of policy in so many countries to limit or reduce relations of dependency in banking, and why the belief is so widespread that an indigenous banking sector is an indispensable part of economic development. Historical experience is always in many respects unique. However, situations today do often have analogies with those of the past. Moreover, historical experience is an abundant source of perceptions, political folklore and other determinants of attitudes towards foreign banks and international banking transactions.

A. Financial dependence on New York in the ante-bellum South - London as global financial pivot before 1914

The plantation economy of the Southern States of the United States before the Civil War furnishes an interesting example of dependence for the services needed for its trade and payments on external suppliers, in this case middlemen and bankers in New York City and elsewhere in the North-east of the country.[26] Via a system of intermediaries in which a key role was played by agents known as factors, cotton planters depended on bankers from New York and the North-east for long-term loans for the purchase of land and slaves, for the short-term borrowing necessary for buying supplies, and for the realization of their receipts from the sale of their crops.

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[25] For a review of the sort of difficulties likely to confront such interpretation see Clark, *Studies in the Economics of Overhead Costs*, chap. XX.

The short-term credit was usually provided through arrangements highly favourable to the factors. For example, in return for making such credit available, the factor was given the exclusive right to sell the borrowing planter's crop. Under another frequently used arrangement the factor was guaranteed a minimum number of bales, and his commission as selling agent was paid on this number even when there was a shortfall in production. The interest rates under these financing and payments arrangements tended to be fairly high. Moreover, the receipts accruing to planters were subject to further risk in that payment typically consisted of a draft or bill payable in two to four months in New York. Such a bill or draft could be discounted at a rate depending on conditions in financial markets over which planters had no control. Planters were generally under pressure to receive payment quickly. In the event of one of the periodic financial crises experienced in New York, the bills and drafts could be discounted only at rates involving heavy losses. Resentment at this financial dependence and the desire to substitute direct trading and financial relations with export markets in Europe became one of the reasons for growing pressures in the South for secession from the Union.

The dependence of whole regions on highly localized financial and entrepôt centres for the services required for international trade has been common throughout history. Perhaps the outstanding instance during the last two centuries is provided by London, where suppliers of all the main types of service required for international trade have long been clustered together. During its halcyon period before the world war of 1914-1918, London's dominance of world banking was such that "if a man in Peru wished to send money to a man in Afghanistan, the final payment, as like as not, would be made by a bookkeeping transaction in London".[27] Dependence on financial centres has not always been a source of resentment such as that which characterized relations between the ante-bellum South and banks in the North-east United States, since their pre-eminence was often acknowledged as being associated with efficient provision of banking and other trade-related services. Nevertheless, there has been inevitable growth of the perception that international banking can be highly profitable, and that the activities of which it consists demand skills which can be acquired by anyone (although development of a financial centre also depends either on location conducive to economies of scope or, as in the case of present-day offshore centres,[28] on the willingness of the government to extend tax and regulatory advantages). This perception unsurprisingly often acts as a stimulus to efforts to promote indigenous enterprises capable of international banking in countries lacking them.

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[26] This account of the financial dependence of the South is based on D. Dillard, *Economic Development of the North Atlantic Community: Historical Introduction to Modern Economics* (Englewood Cliffs, New Jersey, Prentice-Hall, 1967), pp. 344-49.

B. Foreign banks in Africa before 1950

Various aspects of the performance of foreign enterprises supplying financial services in Africa between the 1880s and the 1950s illustrate reasons for the convictions in developing countries concerning the need for an indigenously controlled banking sector. This performance was marked not only by omissions as regards the financing of indigenous development but also by involvement in non-commercial political or administrative functions. The latter historical role of such enterprises has undoubtedly left lasting traces in political attitudes.

The activities of foreign banks and the spread of their networks in Africa during this period were in general closely linked to the interests of enterprises from their home countries. Some of the larger of these enterprises were highly diversified, and were themselves suppliers of several banking services (in some cases being responsible for the establishment of banks). Financing from these sources went mainly to expatriates, a large part of the borrowing being used for such purposes as foreign trade and mortgages. The capital needs of indigenous farmers, traders and peasants were mostly met in other ways, for example, from money lenders and associations for mutual help.[29] The failure of foreign banks to be more active in the promotion of indigenous development was due not only to their links to expatriates but also to the lack of borrowers with suitable collateral and of lending opportunities which would have been considered suitable according to these banks' usual guidelines. Indeed, such promotion would have been possible in most cases only if the banks had assumed a much more entrepreneurial role than that to which they were accustomed in their home countries.[30]

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[27] C. Quigley, *Tragedy and Hope: A History of the World in Our Time* (London, Collier-Macmillan, 1966), p. 68.

[28] Such offshore centres may not be particularly relevant to a discussion of the rationale of policies promoting indigenous participation in international banking, since the banks using them frequently have at most limited links with the economies where the centres are located.

The large, diversified enterprises were in some cases more entrepreneurial. But the banking and trade-related services provided by them generally either met the needs of their own constituent businesses or those of other expatriate firms. Moreover among these enterprises were those whose activities often went beyond the commercial sphere and extended to involvement in political and administrative matters.[31] Their role in such cases might include the use of police powers and the collection of customs duties and other taxes, not to mention the exercise of great influence over the character and direction of government in the countries in which they operated.[32]

V. CREDIT ALLOCATION AND DEVELOPMENT POLICY

As noted in the introduction to these notes, finance offers powerful means of control.[33] Credit can thus be an important instrument for influencing the pace and character of economic development. Consciousness of the potential role of banks as tools for promoting industrialization first became widespread in the second half of the nineteenth century. The involvement of the Crédit Mobilier (established by the Pereire brothers in France) in the provision of long-term financing to industry is often cited as the most notable pioneering example in this regard. But more systematic links with more pervasive effects were those between large banks and industry in Germany. The strength of these links was based on the broad range of financial services that such banks furnished to industrial enterprises services which included short-term and long-term lending, the underwriting and marketing or placement of securities, and the making of equity investments on their own account. A major manifestation of these links was the appointment of bank officials as directors of industrial enterprises. It was thus frequently true that "a German bank, as the saying went, accompanied an industrial enterprise from the cradle to the grave, from establishment to liquidation throughout all the vicissitudes of its existence".[34] Among the results generally attributed to German banks' close involvement in industry during the period between the 1850s and 1914 were great influence over the evolving structure of the country's industry, in particular as a result of their role in promoting mergers, amalgamations and cartelization, and a significant contribution to its technical innovativeness.[35]

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[29] Concerning these lending patterns of foreign banks in Africa see, for example, P.L. Wickins, *Africa 1880-1980. An Economic History* (Cape Town, Oxford University Press, 1986), pp. 60, 63, 94, 120 and 145.

[30] British banks, for example, typically preferred the provision of short-term credit. While this should not have excluded meeting demands for such lending from indigenous as well as expatriate economic agents, it did serve as an impediment to longer-term lending for development.

[31] For example, the 1889 charter of the British South Africa Company, *inter alia*, gave it authority to "make treaties, promulgate laws, preserve the peace, maintain a police force and acquire new concessions" (quoted in Dillard, *op. cit.*, p. 490).

[32] See, for example, Wickins, *op. cit.*, pp. 21-24 and 43-46.

[33] As a recent study of the relation between financial systems and economic policy in a number of OECD countries put it, "Very simply, in market economies. . . money

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is not only a medium of exchange but also a means of political and social control: it is one way of deciding who gets what.", J. Zysman, *Government, Markets and Growth. Financial Systems and the Politics of Industrial Change* (Oxford, Martin Robertson, 1983), p. 8.

[34] A. Gershenkron, "Economic backwardness in historical perspective", in B. Hoselitz, ed., *The Progress of Underdeveloped Countries* (Chicago, Chicago University Press, 1952) and reprinted in A. Gershenkron, *Economic Backwardness in Historical Perspective. A Book of Essays* (Cambridge, Massachusetts, the Belknap Press of Harvard University Press, 1962), p.14.

[35] Alfred Marshall quotes a pamphlet of this period by William Olsson, a Swede who had undertaken a comparison of the methods of finance in Germany, Britain and other countries as follows: "[in Germany] the pioneer would take his proposal to one of the great banks with an Industrial department; and the proposal would immediately be put before experts, scientific and technical, well known to the bank and thoroughly trusted who (on the assumption that the proposed business was really good) would report well on it, *and would be believed*". Marshall clearly thought that the scale of the effort made by German banks in the scientific and technical sphere was exceptional. A. Marshall, *Industry and Trade*, 4th edition (London, Macmillan, 1923), pp. 347-48.

Recognition in countries now developed of the potential usefulness of controlling credit allocation as part of economic policy has not been limited to cases where banks had a central role in the mobilization of the resources required for laying the foundations of national industry. For example, during much of the period since 1945 governments in OECD countries have intervened in the process of credit allocation through measures designed to influence the price and pace of lending for different purposes.[36] This intervention has taken place both as part of overall industrial policies and in pursuit of narrower or sectoral goals such as export promotion and aid to agriculture.

Intervention of an analogous kind is a well-established feature of economic policy in most developing countries. Such intervention can be classified under five main categories: lending requirements imposed on banks, schemes for refinancing loans, lending at preferential interest rates, credit guarantees or insurance, and lending through specialized financial institutions designed to provide types of lending believed to be otherwise unavailable or insufficient.[37] In many instances the intervention has a long history. In several countries in Africa, for example, the original introduction of such policies, especially the establishment and promotion of financial institutions for particular purposes, was a response to foreign banks' concentration on expatriates and the difficulties faced by indigenous economic agents in obtaining loans. Policies of this kind were already under way in a few cases early in this century. One example was the establishment in Egypt in 1902 of an Agricultural Bank designed to provide cheap credit to poorer peasants. However, the main beneficiaries of most of these early efforts in other African countries were colonial settlers engaged in farming.[38]

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[36] The reference here is not to policies designed to influence or control broad lending aggregates as part of macro-economic policy. It should, however, be noted that in practice the macro-economic and the other dimensions of credit policy cannot be kept separate, since measures to regulate the quantity of credit are often accompanied by attempts to influence the direction of banks' lending. See, for example, the remarks on qualitative credit controls in Wilson, *Banking Policy and Structure: A Comparative Analysis*, pp. 420-21.

[37] This classification is similar to that in The World Bank, *World Development Report, 1989* (New York, Oxford University Press, 1989), p. 56.

[38] Concerning early initiatives as regards the provision of credit by governments in Africa see Wickins, *op. cit.*, pp. 83, 120, 138, 161 and 223.

The record of government intervention in credit allocation in developing countries, as in developed ones, has been mixed, including many successes as well as failures. The banks in developing countries through which such intervention was carried out did not escape the spread of financial distress during the 1980s, which has affected financial institutions in most major regions of the world economy.[39] This distress is often connected to the policies that financial institutions were used to promote, and in many instances reflects mismanagement and inadequate regulation. But it should also be noted that policies to influence credit allocation become more difficult to implement successfully in an environment of macro-economic instability (such as that which followed the debt crisis in several developing countries), and one in which particular sectors (such as agriculture) are subjected to strains to a significant extent beyond their control.

In a recent study[40] national financial systems in developed countries are classified under three major types: firstly, capital market-based systems in which there is heavy reliance for long-term financing on borrowing in the form of securities, and relations between governments and borrowers tend to have an arm's-length character; secondly, credit-based systems in which a much larger role in the provision of long-term financing is played by banks and specialized lending institutions, while the government exerts a measure of control over key prices and the allocation of financial resources; and, thirdly, credit-based systems also characterized by a major role for financial institutions in long-term financing but in which government intervention to affect prices and the allocation of lending is more limited. Most financial systems in developing as well as developed countries can be broadly characterized as belonging to one of these three types (though borrower-lender relations in particular sectors may often more closely approximate those in one of the other two). In the context of a possible agreement on a framework for international trade in banking services the most important points indicated by the discussion of this section are that the evidence does not suggest the superiority of any of these three types of financial system over the others, and that reliance on one rather than the others in a particular country should be understood in the light of its historical and current circumstances.[41] Thus incorporation in such an agreement of explicit or implicit assumptions as to the superiority of a particular type of financial system (which would inevitably be a source of pressure to adopt this system on the countries covered by the agreement) is not justified.

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[39] See, for example, The World Bank, *op. cit.*, chap. 5 (where Box 5.1 contains a useful list of major instances of recent financial crises in developed and developing countries).

[40] Zysman, *op. cit.*, pp. 18 and 70-72. The word, "borrowers", has been substituted in the main text for the author's "industry". Zysman's book is concerned with relations between financing and industrial policies, and the substitution is intended to bring out that his categories of financial system have a broader applicability.

VI. FOREIGN BANKS AND THE CONDUCT OF MONETARY POLICY

There is concern in developing countries that liberalization of international trade in banking services is capable of reducing the effectiveness of monetary policy. This concern applies both to the regimes for banking transactions between residents and non-residents and to those for foreign banks with a long-term presence in a country.

As noted in section I.C. the question of liberalizing banking transactions between residents and non-residents cannot be abstracted from that of foreign exchange control. Exchange control with respect to financial transactions may serve major objectives of a country's monetary policy such as those regarding inflows and outflows of capital and the level of exchange rate. Thus the strategic nature of such control may have an important influence on the nature of commitments that developing countries are prepared to make as to the liberalization of trade in banking services between residents and non-residents.[42] In the case of foreign banks with a long-term presence in a country, concern as to the possible consequences of their operations for the effectiveness of monetary policy stems from the belief that such banks typically have better access than domestic ones to external sources of funds, and that, thanks to their links to other banks abroad owned by the same parent, they also have greater latitude as regards their lending. Thus it is feared that foreign banks may borrow from external sources in order to evade the impact of policies designed to restrain monetary expansion, and that they may use their connections with banks abroad to shield borrowers from other effects of restrictive monetary policies. A further concern about foreign banks in the context of monetary policy is that they may be less susceptible to "moral suasion" than domestic ones.

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[41] This statement should not be taken as suggesting that the functioning of particular financial systems of any of the three types could not usually be improved.

[42] Controls over international capital transactions are permitted under Article VI of the IMF Articles of Agreement, of which section 3 provides that "Members may exercise such controls as are necessary to regulate international capital movements" subject to certain provisos, such as that measures for this purpose should not conflict with a member country's commitments under Article VIII as to the convertibility of its currency for current transactions.

Some of the instruments of monetary policy take the form of open-market operations designed to increase or decrease banks' reserves, and by this means to influence their liquidity and the level of interest rates. Other instruments affect reserves, lending and interest rates more directly. These include the imposition on banks of minimum ratios of cash to deposits, the setting of ratios of liquid to total assets, the immobilization of part of banks' lendable resources, limits on the amount banks may borrow from the central bank, ceilings on the pace of banks' lending, measures designed to restrain the growth of banks' interest-bearing deposits (such as the siphoning-off of increases above prescribed levels into special deposits with the central bank that pay no interest), and direct control of interest rates. Ceilings on the pace of banks' lending may be accompanied by attempts to influence its direction. The authorities' recourse to persuasion (the "moral suasion" to which reference was made above) takes place principally with regard to the pace and qualitative character of lending but also in some cases involves other matters such as levels of interest rates.

The degree of reliance on the different instruments of monetary policy varies greatly among countries. The relative importance of open-market operations has tended to increase in most OECD countries during recent years. However, heavy reliance on these so-called "classical" techniques of monetary policy is possible only in countries where there exist well developed money markets (that is to say markets for liquid, mostly short-term financial assets). This precondition is rarely met in developing countries, which in consequence have to place greater reliance on the more direct methods of controlling credit and interest rates. The increased prominence of the "classical" techniques of monetary policy in developed market-economy countries has tended to be accompanied by reduced recourse to "moral suasion", which has, however, not disappeared in such countries.[43] As might be expected, "moral suasion" plays an important part in the conduct of monetary policy in several developing countries.[44]

The possibility for banks of borrowing abroad in such a way as to frustrate the impact of monetary policy depends partly on the incidence of a country's banking regulations. For example, use of such borrowing to evade policies to reduce the growth of credit in the economy can be rendered impossible by appropriately designed regulations. Nevertheless, certain practices remain difficult to control under any regulatory system leaving economic agents some degree of latitude as regards the nature of particular banking transactions. Moreover, it should be emphasised that recourse to these practices need not be limited to foreign banks, since they are also available to local ones with foreign branches or subsidiaries.

These points can be illustrated for the technique of back-to-back loans, in a case involving a local borrower (denoted here as firm L) and an enterprise under the same ownership abroad (firm F), on the one hand, and a local bank (bank L) and one under the same ownership abroad (bank F), on the other. Firm F makes a deposit in a foreign currency at bank F, while bank L lends a corresponding amount in local currency to firm L.[45] When monetary policy is being tightened, the loan by bank L may carry a rate of interest below market levels, firm F frequently in such cases also receiving a low rate of interest on its deposit. The bank L in this scenario is not necessarily foreign-owned. On occasion locally-owned banks in developing countries with foreign branches or subsidiaries also have had recourse to such operations.[46]

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[43] Concerning the use of "moral suasion" in developed market-economy countries see, for example, Wilson, *Banking Policy and Structure A Comparative Analysis*, pp. 382-83.

[44] In a survey published in 1982 of the financial systems of six developing countries in South-east Asia an important role as part of monetary policy was explicitly attributed to "moral suasion" in four, namely Hong Kong, Malaysia, Singapore and Thailand. S.Y. Lee and Y.C. Jao, *Financial Structures and Monetary Policies in Southeast Asia* (London, Macmillan, 1982), pp. 39-40, 43, 48-49, 86-87, 118 and 165.

[45] Back-to-back loans are described in D. Ross, I. Clark and S. Taiyeb, *International Treasury Management* (Cambridge, Woodhead-Faulkner, 1987), pp. 151-52.

[46] Concerning the use of back-to-back loans by banks of Latin American countries,

Similarly domestic as well as foreign banks may resist "moral suasion". Nevertheless, there is a presumption that domestic banks are generally more biddable than foreign ones owing to the greater importance to them of the authorities' regulatory favour, of facilities provided by the central bank, etc. This biddability may be strengthened in the case of domestic banks if their major shareholders include the government.[47]

In the context of a possible agreed framework for international trade in banking services the relation of the presence of foreign banks to the conduct of monetary policy thus raises matters bearing on the issue of market access for such banks. Some countries may be reluctant to grant foreign banks right of entry to those parts of the banking system, control over which is regarded as indispensable to the conduct of monetary policy. Governments in other countries may have apprehensions concerning the presence of foreign banks for the same reason, while nonetheless being unwilling to impose an outright ban on the entry of foreign banks to the sub-markets in question because of the prejudice which this would cause to other policy objectives. Any guidelines adopted as part of an agreed framework would need to acknowledge the great sensitivity of most governments concerning the question of maintaining autonomy in the conduct of monetary policy. One approach which might merit consideration here would entail acceptance that the granting to foreign banks of access to certain sub-markets would be provisional in the sense that it could be withdrawn if the banks in question engaged in operations that conflicted with national monetary policy. However, it should be noted that whereas such an approach would provide governments with flexibility in this area, its embodiment in actual guidelines may not be a simple matter. For example, such guidelines would need to provide for some form of redress in cases where there were good grounds for believing that the ostensible withdrawal of a banks' licence owing to operations prejudicial to the conduct of monetary policy was in reality due to other causes not ac-

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for example, see B. Kucinski, "Where parallel loans may meet", *Euromoney*, January 1984.

[47] On the way in which the government's shareholdings are capable of facilitating "moral suasion" see Lee and Jao, *op. cit.*, p. 118.

ceptable for this purpose under an agreed framework for trade in banking services.

VII. SOME EVIDENCE CONCERNING RESTRICTIONS ON FOREIGN BANKS' MARKET ACCESS AND OPERATIONS IN DEVELOPING COUNTRIES

Recurrent surveys of the treatment of foreign banks in developing countries are not available. It seems reasonable to assume that a mechanism for producing such surveys would be a required feature of an agreed framework for international trade in banking services owing to the importance for its application of up-to-date information. At present the most recent comprehensive study of restrictions on entry and operations faced by foreign banks remains that undertaken for the United States Department of the Treasury in 1979.[48] This study was followed by two updating exercises in 1984 and 1986, but the numbers of developing countries included were small - eight in 1984 and ten in 1986.[49]

Although the results of the 1979 study can no longer be taken as an accurate representation of the position in particular countries, its overall picture of the situation continues to be of interest for its illustration of the wide variety of restrictions and regulations used in this context, and its evidence concerning the relation between policies towards foreign banks, on the one hand, and such characteristics of countries as their levels of economic and financial development, on the other. The study contains a classification of countries by the degrees of the restrictiveness of their policies towards the entry of foreign banks, which is shown in table 1. The degree of restrictiveness decreases in the table from (B) to (E), and each country is included only in the most restrictive category applying to it. Categories (B) and (C) are self-explanatory. The restriction of foreign banks to representative offices

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[48] Department of the Treasury, *Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations* (Washington, D.C., September 1979) (henceforth cited as *National Treatment Study*).

[49] Department of the Treasury, *Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations 1984 Update* (Washington, D.C., July 1984) (henceforth cited as *1984 Update*) and *idem*, *National Treatment Study 1986 Update* (Washington, D.C., December 1986) (henceforth cited as *1986 Update*).

(category (D)) precludes the taking of deposits and the making of loans, such offices serving merely as vehicles for soliciting and developing business relationships on the spot. Branches, the subject of the prohibition specified in (E), are integral parts of the parent bank and can borrow and lend. Banks may also expand abroad through subsidiaries and affiliates. The first of these forms is a legally separate entity in which the original bank holds a controlling interest, while the second denotes an enterprise of which the bank owns less than a majority of the equity. Some of the countries in table 1 which prohibited branching none the less permitted the acquisition of minority interests in indigenous banks and are thus included in (G) as well as (E).[50]

One point evident from the table is the relatively large number of developing countries found to be imposing no restrictions on the entry of foreign banks, and the prominence within this group of relatively low-income countries, that is to say those with GDP per capita in 1980 either below $500 or between $500 and $1500. Another point about the figures in the table which should be noted is that their implications for a bank differ according to its preferred strategy of expanding its presence abroad. For example, United States banks tend to prefer the branch form for such expansion, especially during its early stages.[51] Thus for United States banks the relatively large number of developing countries prohibiting entry through branching has particular significance. More generally, the table suggests the lack of any clear-cut relation between the restrictiveness of countries' policies towards the entry of foreign banks and levels of economic and financial development.[52]

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[50] The maximum permitted size of foreign banks' interest in indigenous banks varied among the countries in the survey from 10 to 50 per cent. Some countries which did not permit branching by foreign banks also prohibited their purchase of any interest in domestic banks. Such countries are included under (F) as well as (E).

[51] See, for example, *National Treatment Study*, pp. 19-20, and Houpt, *op. cit.*, pp. 4-11.

[52] The categorization of developing countries by region and GDP in table 1 is a coarse one. More refined categorizations are capable of generating various statistically significant relations between countries' policies towards foreign banks and the characteristics of their economies. On the basis of a combined ranking of the countries in the United States Treasury sample by the degree of restrictiveness of their policies as regards both entry and operations, one study finds several significant associations between restrictiveness and various characteristics of countries' governments, of their economic and financial policies in other areas, and of the relations between their economies and banks and those abroad. A.E. Tschoegl, "The

The 1979 study of the United States Treasury also surveyed various restrictions and other discriminatory measures affecting foreign banks' operations. Many of these restrictions are designed to protect domestic banks, but some are also imposed primarily for prudential reasons.[53] Among those cited in the study were restrictions on foreign banks' access to deposits and limits on their branching networks (both of which were found to be particularly prevalent), the non-availability of discount facilities at the central bank, limits on diversification that excluded foreign banks from major sub-markets, differential regulations as to capitalization, requirements concerning the nationality of staff, and differentially higher rates of taxation.[54] The form that restrictions took might differ among countries. For example, limits on access to deposits might involve prohibitions on accepting particular types of retail deposit or restrictions on access to the deposits of public-sector institutions. The various kinds of differential regulation as to capitalization frequently were due at least in part to prudential considerations. One such regulation reflected the decision to treat branches of foreign banks as entities independent of their parents, and thus to limit their lending to a multiple of the branches' own capital rather than the combined capital of the branches and their parents.

Not all the differential treatment described in the 1979 study and the 1984 and 1986 updating exercises was unfavourable towards foreign banks. Thus, for example, in India foreign banks, unlike nationalized domestic ones, are not required to open branches in rural areas or to lend to small, frequently high-risk borrowers at concessionary rates of interest. In Republic of Korea foreign banks have benefited from ex-

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regulation of foreign banks: policy formation in countries outside the United States", *Monograph 1981-2 of the Monograph Series in Finance and Economics of the Salomon Brothers Center for the Study of Financial Institutions* (New York, Graduate School of Business Administration, New York University, 1981).

[53] *National Treatment Study*, chap. 6, summarizes the findings concerning restrictions on the operations of foreign banks.

[54] The distinction between restrictions on country and those on operations in *National Treatment Study* does not coincide precisely with analogous concepts in section VIII. Thus "market access" in section VIII refers to admittance to particular banking sub-markets, while "entry" in *National Treatment Study* denotes admittance to any part of a country's banking system. In consequence certain measures classified as restrictions on foreign banks' operations in *National Treatment Study* (such as those limiting diversification of their activities by banks that have obtained "entry") belong under the heading, "market access", of section VIII.

emption from requirements to support government bond issues and to devote substantial proportions of their lending to specific sectors, while also enjoying certain tax privileges. Legal lending limits for foreign banks in Taiwan Province of China were found in the 1984 study to be less restrictive than those for domestic ones.[55] Perhaps mention under the heading of differentially favourable treatment for foreign banks should also be made of the exemption of Citibank from the nationalization of banks in Mexico in 1982.

The updating exercise carried out by the United States Treasury in 1984 comprised only eight developing economies - Brazil, India, Republic of Korea, Mexico, Philippines, Thailand, Venezuela and Taiwan Province of China, and that of 1986 covered the same group plus Argentina and Singapore. The two studies focused principally on restrictions on foreign banks' operations, although developments involving entry were also mentioned in cases where they had taken place. The changes between 1979 and 1984 cited were mostly modest. On balance some relaxations in levels of restrictiveness were found in three economies, India, Republic of Korea and Taiwan Province of China, and some increase in Philippines and Thailand, while no significant change was identified in Brazil, Mexico and Venezuela.[56] Little change appeared to have taken place between 1984 and 1986 except in Republic of Korea and Taiwan Province of China (although the continuing entry of additional foreign banks was noted in the case of India). In Republic of Korea and Taiwan Province of China foreign banks were found to have benefited from significant relaxations of operating restrictions closely associated with the more general programmes undertaken to liberalize the two countries' banking systems.[57]

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[55] Concerning differentially favourable treatment of foreign banks see, for example, *National Treatment Study*, pp. 31, 63 (India), and 83 (Republic of Korea); *1984 Update*, pp. 18 (India), 30 (Republic of Korea), and 56 (Taiwan Province of China); and *1986 Update*, pp. 119 (India) and 125-126 (Republic of Korea).

[56] For the synopsis of the study's findings see *1984 Update*, pp. vi-vii. The details are contained in separate chapters devoted to particular countries.

[57] The synopsis for 1984-1986 is contained in *1986 Update*, pp. 5-10, country details being given in separate chapters, as in *1984 Update*.

VIII. THE APPLICATION TO TRADE IN BANKING SERVICES OF KEY CONCEPTS AND PRINCIPLES

A. Introduction

As mentioned earlier, certain concepts and principles bearing on central features of a possible agreed framework for international trade in banking services were singled out for special attention at the mid-term review of the current multilateral trade negotiations completed in April 1989. No attempt will be made here at a blueprint for the integration of these concepts and principles into such a framework, a task best left to the negotiators. Rather the discussion which follows takes up aspects of the concepts and principles and of their interrelations suggested by the discussion of trade in banking services in previous sections. Since the more difficult points in this context seem mostly to be associated with transactions that entail the long-term presence of suppliers in developing countries, trade in banking services of this kind is the principal focus of the discussion which follows.

It is convenient to begin with the three concepts that are at the heart of the issues at which an agreed framework would presumably be directed, namely "market access", "national treatment", and "progressive liberalization". Various matters discussed under these three headings also have a bearing on "most-favoured-nation non-discrimination" and "increasing participation of developing countries", the concepts which are thus taken up next. "Transparency" and "regulatory situation", which have a number of interrelations, follow, and the final concept discussed is "safeguards and exceptions".

B. Market access

It is important to make a clear distinction between "market access", which covers the right of entry to particular banking sub-markets, and "national treatment", which concerns the treatment received from the authorities by a supplier of banking services after the granting of such access. Control over market access is the policy instrument perhaps most crucial to enabling governments in developing countries to choose the banking regimes which they believe to be most appropriate to their particular circumstances and needs.[58] As emphasized in section I.A, banking consists of several sub-markets, and the access granted to foreign banks generally applies only to certain of them. Thus control over such access makes it possible for governments to pursue policy objectives towards the different constituent parts of a country's banking system.

These policy objectives may concern various subjects discussed elsewhere in these notes. Particularly important here are the objectives which may be pursued through infant-industry policies for financial sectors and other policies that can be expected to play a role in eventually increasing the participation of developing countries in international trade in banking services. Thus, for example, control over market access can serve as an instrument for the achievement of the transfer of banking skills. Furthermore such control can be used to influence the level and character of competition in banking. By this means it should be possible to avoid certain adverse effects of such competition (mentioned above in section III), while employing the entry of foreign banks as a stimulus to increasing efficiency among indigenous ones. In particular, control over market access enables governments to restrict activities likely to be associated with financial instability, and to protect indigenous banks from premature exposure to unfair pricing practices. Moreover, as already noted in section VI, control over market access may enable governments to reconcile the objectives of liberalizing regimes for foreign banks, on the one hand, and of maintaining desired levels of autonomy in the conduct of monetary policy, on the other.

C. National treatment

The principle of national treatment is designed to ensure that foreign suppliers are not subject to discriminatory treatment under a country's internal taxes, laws and regulations. In the case of international trade involving services provided by non-resident banks, national treatment would appear to have implications similar to those for trade in goods.[59] But in the case of services supplied by a foreign enterprise with a long-term presence in the country in question, different problems have to be faced. Thus for banking services provided in this way national treatment is intended to ensure to foreign banks a measure of equality of competitive opportunity. It should be emphasized that the degree of competitive equality thus afforded will necessarily be less than complete. Several types of competitive inequality among enterprises may exist even in instances where laws and regulations do not discriminate in any way in favour of particular suppliers. For example, competitive advantages may accrue to certain enterprises mainly as a result of being early entrants into an industry or market, and may have adverse implications for other domestic as well as foreign suppliers. Such cases, which are a commonplace of industrial economics, may sometimes be an appropriate subject for the country's competition policy, but the remedy does not belong under the heading of national treatment.

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[58] The remarks in the main text concentrate on the strategic policy rationale of control over market access. An agreed framework for international trade in banking services may also need to cover various matters related to modalities such as the procedures to be followed when there is a change in the nationality of the parent institution of a bank branch or subsidiary which has been granted market access.

So long as a country has control over market access, it is reasonable to assume that the presence of foreign banks in particular banking sub-markets is in accord with (or at any rate is not in conflict with) the government's policy objectives. In such circumstances strong arguments can be put forward that the regulatory and tax regime should be the same for foreign as for domestic banks. Nevertheless, this principle is likely to be accepted only subject to various provisos, of which three possible examples will be taken up here.

Firstly, reference was made in section VII to several countries which imposed on foreign banks differential requirements as to capitalization for prudential reasons. Such measures can be justified by differences in the regulatory regimes under which domestic banks and the parent institutions of foreign banks operate, and by a degree of confidence concerning the support likely to be forthcoming from its parent to a foreign bank in difficulties that is lower than in the case of an analogous situation involving a domestic bank. It should be added that the reasons that justify differential capital requirements for foreign banks also draw attention to the desirability of improved co-ordination among the supervisory authorities of the countries that would be covered by an agreed framework for international trade in banking services, a subject discussed further below under "transparency" and "regulatory situation".

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[59] These implications have been discussed at length in the literature. For a useful summary see E. McGovern, *International Trade Regulation: GATT, the United States and the European Community* (Exeter, Globefield Press, 1982), chap. 8.

Secondly, if allowance is to be made for infant-industry protection for domestic banks in developing countries, references in an agreed framework to national treatment may need to accommodate measures designed to serve this objective such as differential income or profit taxation. The concept of national treatment in article III of the General Agreement is intended to apply to goods supplied by non-residents, and permits the levying of import taxes at the frontier. It is thus compatible with infant-industry tariffs. When banking sub-markets are supplied by firms on the spot, this option is not available. But higher income or profit taxation for foreign banks or restrictions designed to impose differentially higher operating costs[60] on such banks could be used for the same purpose. The danger here is that infant-industry protection by such means could easily become a way of driving a coach and six through the obligations entailed by national treatment. This danger might be avoided if recourse by a country to infant-industry protection were to be hedged with a duty to specify both the particular tax or restriction used and a limited duration for the period of protection.

The third proviso relates to regulations that have the effect of increasing the hiring of locals by foreign banks. Such regulations may be an important vehicle for achieving the transfer of banking skills. As was mentioned in section III, the transfer of skills is a major element of the rationale for admitting foreign banks to developing countries, so that it would be incongruous if an agreed framework were not to accommodate staffing regulations intended to achieve this aim.

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[60] Restrictions on the operations of banks are often classified according to their "tax-like" or "quota-like" characteristics. The former raise banks' costs in a manner analogous to the effect of a tax, and thus suggest themselves as a substitute for tariffs. Examples of "tax-like" restrictions are differential reserve requirements, limits on or prohibitions against accepting retail deposits, and lack of access to refinancing facilities at the central bank. See, for example, *National Treatment Study*, p. 15.

D. Progressive liberalization

The earlier discussion of these notes, in particular that in section III, indicated that liberalization and increased competition in banking can be expected to result in both benefits and costs. The thrust of policy towards this sector during recent years in developed market-economy countries has been in the direction of deregulation. However, during earlier periods policy was characterized by less emphasis on the benefits of competition, and deliberate use was often made of banks as instruments for the achievement of sectoral and developmental goals. There is thus no reason to anticipate generalized willingness among governments in developing countries to view liberal banking systems as being appropriate to their circumstances and needs. Various steps (some of which are mentioned below) might be undertaken as part of an agreed framework for trade in banking services to enhance the prospective benefits of liberalizing regulations affecting the entry and operations of foreign banks. But the possibility remains that a substantial number of countries will still choose not to make significant moves in this direction.

This possibility raises important questions as to the relation not only of "progressive liberalization" but also of other key concepts and principles to an agreed framework. The way in which the possibility might be handled depends partly on whether a framework for banking is to be part of a larger, overall agreement also covering other service sectors, or whether it is to stand alone. If the former option is chosen, cross-sectoral concessions can be envisaged under which countries unwilling to liberalize restrictions in banking may none the less be prepared to make offers for other services. By enabling such countries to participate in an overall agreement, offers of this kind would make them eligible for benefits under a framework for trade in banking services even in the absence on their part of concessions affecting this sector.

However, if an agreed framework for banking were to be separate or self-contained, more intractable problems might arise. In this case the unwillingness of countries to reduce restrictions on the entry and operations of foreign banks could not be balanced by concessions involving other services. Reciprocity has been a significant influence in many developed and developing countries on their willingness to grant market access to foreign banks.[61] Thus it is difficult to visualize general acceptance by participants in a separate agreement on trade in banking services that countries unwilling to commit themselves to reduce restrictions on foreign banks should be eligible for benefits under the agreement.

There remains the question of what kinds of commitment to liberalization might be acceptable for an agreement. Such commitments would not necessarily need to be large so long as the framework for banking was part of a larger, overall agreement, since in this case they could be accompanied by concessions affecting other sectors. For a separate agreement on banking, willingness to accept commitments to liberalization would almost certainly be enhanced by allowing for considerable discretion as to the timing of the phasing-in of the measures to be taken. Articles VIII and XIV of the IMF Articles of Agreement may provide a useful precedent in this regard.

Article XIV allows a member of the IMF to avoid committing itself to the obligations of article VIII as to the convertibility of its currency. Instead the member may avail itself of transitional arrangements under which it is permitted "to maintain and adapt to changing circumstances the restrictions on payments and transfers for current international transactions that were in effect on the date on which it became a member". Article XIV is especially interesting in the context of a possible framework for trade in banking services owing to two of its provisions. Firstly, although under the article a member may "adapt" its restrictions to changing circumstances, introduction of new restrictions and the reintroduction of restrictions withdrawn are not permitted. Secondly, article XIV does entail the commitment to move in the direction of a more liberalized foreign exchange regime. However, it should be noted that while the flexible modalities of article XIV may provide an interesting precedent in the context of the application of "progressive liberalization" to trade in banking services, the article presupposes as an ultimate objective a particular norm of convertibility, namely that in article VIII. An analogous norm in the field of banking would have to be defined more loosely to allow for the variety of different banking regimes that participants in an agreed framework for this sector could be expected to wish to maintain.

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[61] Reciprocity is not a precise term in this context. It covers policies under which countries admit banks from another country only if their own banks are granted broadly similar opportunities in that country. The lack of precision concerns what are acceptable as broadly similar opportunities. Mirror-image reciprocity is not generally insisted on owing to the discriminatory nature and complexity of policies based on this principle. Other possibilities range from the granting of national treatment to more stringent conditions that still fall short of mirror-image reciprocity. For a discussion of the role of reciprocity in the arrangements for the completion of a single market in the European Community as well as in the current multilateral trade negotiations see Lord Douglas Croham, "Reciprocity and the unification of the European banking market", *Group of Thirty Occasional Papers 27* (New York, Group of Thirty, 1989).

E. Most-favoured-nation/non-discrimination

Inclusion of the most-favoured-nation principle in an agreement on international trade in banking services would be intended to prohibit discrimination among the parties to it, thus guaranteeing that concessions made by one party would be equally accorded to all. However, extension of this principle from its usual field of application, trade in goods, to services such as banking raises new problems, two of which are discussed here owing to their bearing on other matters discussed in these notes.

Firstly, there is the question of the relation of the most-favoured-nation principle to the form of an agreement or agreements concerning services more generally and banking in particular. Presumably, as in the case of "progressive liberalization", the principle would apply to all parties to an overall agreement covering several services, if banking were part of such an agreement, but would be limited to the parties to a separate agreement on banking if this was the form of agreement reached.

Secondly, the identity of the parties to which the most-favoured-nation principle would apply presents peculiar difficulties in the case of trade in banking services. If the definition of such trade were to be limited to transactions between residents and non-residents, the principle would seem to involve issues similar to those arising in the case of trade in goods. But its application to transactions associated with the long-term presence of suppliers on the spot is less straightforward. The granting of market access must be bank-specific and not to countries if, as suggested above, it is to be used as a policy instrument for such purposes as providing infant-industry protection. Restriction of market access to banks from countries covered by an agreement and granting it to such banks on the basis of first come first served might be considered as representing a form of non-discrimination among the parties. However, it would be non-discrimination in a sense different from that traditionally envisaged under the most-favoured-nation principle.

F. Increasing participation of developing countries

The aim of this principle is to increase developing countries' role in international trade in banking services. Banks from developing countries already participate in this trade but to a still limited extent. Further progress for the great majority of developing countries requires first the strengthening of domestic banking systems. Such a strengthening can be expected to lead eventually not only to greater participation by banks from developing countries in banking transactions between residents and non-residents but also to an increase in their presence abroad through the usual means of representative offices, branches, subsidiaries, and affiliates. Thus subjects within the ambit of "increasing participation of developing countries" can be broadly classified under two headings: one comprising measures directed at the domestic banking systems of such countries; and the other measures directly affecting participation in international trade in banking services.

Under the first heading a key point is admission of the right of governments in developing countries to use market access as an instrument for the achievement of policy goals regarding banking . As already discussed, control over market access can be a vehicle for infant-industry protection of the sector. It can also provide developing countries with leverage for the acquisition of knowledge and skills since the granting of market access can be subject to conditions designed to contribute towards this objective. One such condition has already been mentioned, namely requirements as to the hiring of local staff. Others might relate to the transfer of new technologies used in banking and the undertaking of management contracts.[62]

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[62] Such contracts, which have already been used by some developing countries, entail the management of indigenous banks by teams from banks in developed market-economy countries. They are a way of giving a country access to advanced banking

Expansion abroad is likely to continue to be the objective of only a limited number of banks from developing countries during the early years of any agreement. But the pressure for expansion abroad can eventually be expected to grow as the trade of such countries increases and their banking sectors mature. It is difficult to anticipate the character of the impediments to entry and restrictions on operations in the banking sub-markets of developed market-economy countries that will then have to be faced by banks from developing countries. As already noted, the recent thrust of policy in developed market-economy countries towards their financial systems has been in the direction of greater competition and openness. But the eventual policy regimes for foreign banks in such countries will emerge from discussions and negotiations still going on, including those taking place as part of the process of completing a single market in the European Community[63] as well as the current multilateral trade negotiations themselves.

Despite uncertainty concerning these regimes, an agreement on international trade in banking services should address the subject of impediments to developing countries' access to banking markets in developed market-economy countries. In the case of regulatory impediments consideration should be given to the possibility of including provisions for their reduction or removal (if necessary, on a preferential basis), thus increasing the incentives for such countries to participate in the agreement. Moreover whatever the outcome of current negotiations and discussions for regulatory impediments to developing countries' market access, these remains the possibility that it will still be adversely

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technology and management skills while enabling the continuation of local ownership of the banks in question. *National Treatment Study*, pp. 114 and 120.

[63] The Second Banking Directive adopted by the Council of Ministers of the European Community (EC) in December 1989 includes provisions regarding banks owned by parents from countries outside the Community. According to these provisions, subsidiaries owned by non-EC parents that are authorized to operate in one EC member country are eligible for a Community-wide banking licence granting the same freedom of establishment and operations as that enjoyed by EC-owned banks. Branches owned by non-EC parents are allowed to operate only in the country and sub-markets in which they receive specific authorization. Bilateral reciprocity between EC and non-EC countries may continue to apply to the granting of such authorization. For further commentary see "European Community adopts Banking Directive designed to harmonize national banking laws". *IMF Survey*, 5 March 1990, pp. 68-69.

affected by restrictive practices on the part of other banks already present.[64] Such practices, for example, might restrict access to clearance, payments and settlements systems,[65] and might be permitted under the competition policies of the countries in question. Thus it can be argued that an agreement for trade in banking services should explicitly provide for modalities whereby the unfavourable impact of such restrictive practices on market access could be brought to the attention of the parties to the agreement, and redress be sought where appropriate. The availability of such modalities might be more important in facilitating access for banks from developing countries owing to the more limited capacity of their governments for bringing pressure to bear by other means on the countries where restrictive practices were found to exist.

A further matter which may merit consideration under ways of increasing developing countries' role in international trade in banking services relates to the mutual trade of such countries. A rise in banking transactions between developing countries can be expected to accompany expansion of their mutual trade in goods. There is thus a possibility that in this context developing countries may wish to accord each other's banks certain kinds of preferential treatment. A precedent for admitting such treatment subject to appropriate criteria and conditions is to be found in the General Agreement under the decision known as the "enabling clause".[66]

G. Regulatory situation and transparency

Many relevant dimensions of "regulatory situation" have already been treated under previously discussed concepts and principles, in particular under "market access", "national treatment" and "progressive liberalization". The remarks in this subsection are limited to certain matters not yet raised or not sufficiently elaborated earlier. Since these matters are in many cases closely related to the exchange of information among parties to an agreement, some issues arising under "transparency" are also taken up here.

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[64] So-called "club arrangements" in the banking sectors of developed market-economy countries are discussed in the OECD study of Broker, *op. cit.*, p. 89.

[65] Concerning the advantages to banks of participation in a country's payments system (as opposed, for example, to relying for such facilities as cheque clearance on links with correspondent banks) see M.K. Lewis and K.T. Davis, *Domestic and International Banking* (Oxford, Philip Allan Publishers, 1987), pp. 158 and 172-74.

[66] The "enabling clause" permits contracting parties "to accord differential and more favourable treatment to developing countries", and among the arrangements to which such treatment may apply are "regional and global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the contracting parties, for the mutual reduction or elimination of non-tariff measures, on products imported from one another".

Indeed, a key point that deserves emphasis in the context of both "regulatory situation" and "transparency" is the need (already mentioned in section VII) for a vehicle for the regular exchange of information concerning the situation as regards market access for, and restrictions on the operations of, foreign banks in the countries that are parties to an agreement. One model for such a vehicle would be a publication with a coverage analogous to that of the IMF's annual reports, *Exchange Arrangements and Exchange Restrictions* (though owing to the greater inertia in most countries of the regulations in question the periodicity of the publication could be less frequent than that of the IMF).

In the discussion under "national treatment" of prudential regulations that discriminate between domestic and foreign banks, reference has already been made to the desirability of improved co-ordination among national supervisory authorities for banking. Recent years have witnessed a series of steps in the development of a framework of international supervisory co-operation in this area. These steps, principally the result of a series of initiatives of the central bank governors of the Group of Ten countries and Luxembourg, have been directed towards the establishment of principles concerning the distribution between parent and host authorities of supervisory responsibilities over branches, subsidiaries and joint ventures in international banking, the international convergence of regulations as to the capital adequacy of international banks, and the mutual exchange of information.[67] Much of the impetus behind these steps has come from the growth of awareness among the national authorities in OECD countries of their banking systems' vulnerability to disruptions over which, as a result of the internationalization of banking and of divergences in the strictness of national regulatory regimes, they have little or no control. The steps also reflect realization of the need to ensure that banks compete internationally in conditions under which no country's institutions are unduly favoured by particular features of their regulatory regimes so that, as far as possible, success is due to differences in efficiency. Extension of this framework of supervisory co-operation to countries not currently covered might facilitate the removal of discriminatory prudential regulations among parties to an agreement on trade in banking services.

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[67] Although the agreements reached so far cover the Group of Ten countries and Luxembourg, the vehicle for these initiatives, the Committee on Banking Regulations and Supervisory Practices, maintains contacts with other bodies concerned with the supervision of international banking such as the Advisory Banking Committee (and its Contact Group) established to assist the EEC Commission and the Offshore Supervisors Group. See, for example, R. Dale, *Bank Supervision Around the World* (New York, Group of Thirty, 1982), pp. 6-7.

Exchange of information among the supervisory authorities of parties to an agreement may also help towards allaying concerns in developing countries (already mentioned in section III) as to the governability of foreign banks and as to their resort to unfair pricing practices. Concerns as to governability comprise the possible use by banks of their international networks to evade taxes and regulations regarding levels of foreign-exchange exposure, maturity mismatching, etc. Concerns as to pricing practices relate to the scope for foreign banks to deploy price discrimination as a competitive weapon with effects analogous in some respects to dumping in the case of trade in goods.

However, while the willingness of supervisory authorities to make available information regarding the financial positions and any tax or regulatory problems of parent institutions could be of considerable assistance to host authorities, such willingness would be unlikely by itself to remove the aforementioned concerns. For example, those regarding governability could be expected to persist owing to awareness that the capacity of regulatory authorities in developed market-economy countries to monitor banks' international operations remains subject to major limitations,[68] and that its improvement will take time. As for resort by banks to unfair pricing practices, identification of predatory price discrimination is generally very difficult (as already noted in section III), and there would appear to be little case-law in this area covering banks on which an agreement for trade in banking services could draw. Thus there seems little alternative in this connection to accepting that the possibility of unfair pricing practices by foreign banks constitutes another reason for admitting that developing countries need control over market access as an instrument for policies aimed at strengthening domestic banks to the point where they can compete effectively.

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[68] The example of a large international bank which exploited its international network for the purpose of evading banking regulations and reducing its tax burden is discussed in R. Dale, *The Regulation of International Banking* (Cambridge, Woodhead-Faulkner, 1984), Appendix 2.

H. Safeguards and exceptions

Various objectives cited as justifying provision for safeguards and exceptions in an agreement for international trade in banking services can be achieved through control over access to different banking submarkets. For example, as mentioned in section G, such control can be used to ensure that a country maintains autonomy in the conduct of monetary policy. Nevertheless, provision for safeguards and exceptions remains important owing to the need for a proviso to cover unforeseen circumstances in which a country may feel constrained to backtrack with respect to its commitments under the agreement.

Possible instances of such circumstances might be situations of acute balance-of-payments pressure, hyperinflation, or both. Recent events in certain Latin American countries serve as a reminder that in such circumstances governments may decide to deploy unconventional policy instruments in their efforts to achieve economic adjustment or reduce inflation. It is in the nature of such policy packages that their constituents cannot be anticipated in advance. However, in an agreement on trade in banking services allowance seems necessary for the possibility that governments' responses to crises of this kind may include the adoption of discriminatory controls over banking operations which involve temporary infringements of commitments under the agreement.

Table 1

Restrictions on entry of foreign banks [a] in developed market-economy and selected developing counries, mid-1979

	Number of countries
(A) No restrictions	
Developed market-economy countries	9
Developing countries	27
(of which by region)	
Africa	15
Latin America and Caribbean	9
West Asia	1
South and South-East Asia	1
(of which by income group - GDP per capita in 1980)	
Over $1500	8
$500-1500	9
Under $500	10
(B) Prohibition of presence of foreign banks in any form by law [a]	
Developed market-economy countries	0
Developing countries	10
(of which by region)	
Africa	5
Latin American and Caribbean	1
West Asia	1
South and South-East Asia	3
(of which by income group - GDP per capita in 1980)	
Over $1500	3
$500-1500	0
Under $500	7
(C) Prohibition of entry of foreign banks in any form by current policies or licensing practices [a]	
Developed market-economy countries	0
Developing countries	7
(of which by region)	
Africa	2
Latin America and Caribbean	3
West Asia	2
South and South-East Asia	0
(of which by income group - GDP per capita in 1980)	
Over $1500	4
$500-1500	1
Under $500	2

For source and notes see end of table

Table 1 (continued)

Restrictions on entry of foreign banks [a] in developed market-economy and selected developing counries, mid-1979

		Number of countries
(D)	**Prohibition [b] of entry of foreign banks except in form of representative offices [a]**	
	Developed market-economy countries	4
	Developing countries	14
	(of which by region)	
	Africa	1
	Latin America and Caribbean	6
	West Asia	3
	South and South-East Asia	3
	(of which by income group - GDP per capita in 1980)	
	Over $1500	6
	$500-1500	5
	Under $500	3
(E)	**Prohibition [b] of entry of foreign banks in form of branches**	
	Developed market-economy countries	4
	Developing countries	30
	(of which by region)	
	Africa	10
	Latin America and Caribbean	9
	West Asia	4
	South and South-East Asia	5
	(of which by income group - GDP per capita in 1980)	
	Over $1500	12
	$500-1500	13
	Under $500	5
(F)	**Prohibition [b] of any purchase by foreign banks of interest in indigenous banks**	
	Developed market-economy countries	0
	Developing countries	5
	(of which by region)	
	Africa	0
	Latin America and Caribbean	2
	West Asia	0
	South and South-East Asia	2
	(of which by income group - GDP per capita in 1980)	
	Over $1500	2
	$500-1500	1
	Under $500	2

For source and notes see end of table

Table 1 (concluded)

Restrictions on entry of foreign banks [a] in developed market-economy and selected developing counries, mid-1979

	Number of countries
(G) Limitation [b] on purchases by foreign banks to less than controlling interest in in indigenous banks	
Developed market-economy countries	10
Developing countries	23
(of which by region)	
Africa	8
Latin America and Caribbean	4
West Asia	6
South and South-East Asia	4
(of which by income group - GDP per capita in 1980)	
Over $1500	12
$500-1500	7
Under $500	4

Source: Estimates based on Department of the Treasury, *Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations* (Washington, D.C., September 1979), tables 5.2-5.8.

[a] Countries appear under the most restrictive of the headings (B)-(E) to which they belong. Thus a country classified under (B) does not appear under (C)-(G), a country classified under (C) does not appear under (D)-(G), a country classified under (D) does not appear under (E)-(G). However, some countries classified under (E) appear also under (F) or (G).

[b] By law, policy or administrative practice.

PART TWO

OTHER RELATED ISSUES

EC ANTI-DUMPING LEGISLATION AND PRACTICES

*Edmond McGovern**

INTRODUCTION

Apart from certain sectors in which imports are regulated by voluntary restraint agreements (in particular, textiles and steel), anti-dumping measures are by far the most frequently used among the European Community's (EC) range of special trade measures. Countervailing duty proceedings (against subsidized imports) are occasionally invoked,[1] but it seems that little encouragement is given by the EEC Commission, and domestic industries appear ill-informed regarding the possibilities of action. The much greater number of actions commenced in the United States is partly a consequence of the broader interpretation given there to the notion of subsidy.

The New Commercial Policy Instrument (NCPI) has been used on only a handful of occasions, the best known of these being the denial of GSP treatment to the Republic of Korea for its failure to accord Community interests adequate intellectual property protection. The Instrument was introduced in 1984 as an equivalent to the United States Section 301 proceedings (when the latter was merely a discretionary instrument in the hands of the President).

One of the significant features of Community anti-dumping law has been the piecemeal extension of its scope partly by decisions in individual investigations, partly by legislation, and partly by the two acting together. Of the purely legislative advances, the rule on components introduced in 1987 has been the most notorious. In individual investigations the process has been technical in nature, but no less important.

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[1] One is currently in progress against exports of ball bearings from Thailand.

In this context, particular mention may be made of the asymmetrical calculation of costs when sales are made through subsidiaries in both home and Community markets, and both export and domestic prices have to be constructed. Other changes have passed almost without comment, for example the reinterpretation of "sales at a loss" so as to apply to individual models rather than to the overall sales of the relevant goods on the domestic market.

In 1968, the administration of anti-dumping law within the EEC passed from the individual member States to the Community. This does not mean that the member States are without any influence: there is a consultative committee whose approval is required at various stages of the proceedings. However, it rarely acts overtly to block proposals put to it. The source of these proposals is the Commission of the EEC, and in particular the anti-dumping division, which actually carries out the investigations.

In the last three or four years the Community anti-dumping law has become an area of considerable technicality. Numerous decisions on the application of the law to particular problems are to be found buried in the reports of individual investigations, and one suspects that not even the EEC Commission is aware of all the interpretations which have been made.

As a result, this account cannot hope to be comprehensive. Instead what is aimed at is an overall survey of the law and practice, emphasizing those aspects which are likely to be of special interest to exporters in developing countries, particularly those of South-East Asia.

I. DUMPING

Although queries arise on individual points, in general the Community dumping law follows the rules of the General Agreement on Tariffs and Trade. Thus anti-dumping duties may be imposed only if imported dumped products have caused injury to the domestic industry. A product is "dumped" if it is sold at a lower price in the export market than in the home market. The two prices are known as the "export price" and the "normal value". In making the comparison the results of differences caused by factors such as taxes or delivery costs are discounted.

Both elements of the definition give rise to difficulties in their application. For example, as regards the normal value, it often happens that there are no significant sales of the particular article in the home market (the threshold used by the Community is 5 per cent of sales to the EEC). Furthermore, sales made at less than cost may be disregarded. In these circumstances the General Agreement rules say that comparison may be made with one of two prices: either the price at which the article is sold to a third country, or a price "constructed" from the cost of production plus a margin of profit. Of these, the Community invariably chooses the second.[2] Normal value is usually calculated as an average of the sales during the period covered by the investigation (which may be anything from 6 to 12 months preceding the opening of the investigation). This is often broken down into individual months. In calculating the average, individual sales are weighted by their quantities or volumes.

Apart from a few, usually minor, factors, the calculation of normal value from actual sales should be a matter of mathematics. However, if resort is had to constructed prices a greater element of uncertainty (and therefore discretion) is present because of the difficulties of allocating overheads, and more especially, of determining an appropriate profit level. Recent developments in the Community law have tended to result in the determination of profit levels at increasingly higher levels. Levels of over 30 per cent are not unknown.

There may also be difficulties regarding the export price. In particular, the importer may be related (e.g. as a subsidiary company) to the exporter, a factor which obviously casts doubt on the reliability of the amount shown on the invoice. In this case the relevant figure is calculated from the price charged when the importer sells the goods to an independent buyer. The various costs of resale and of ordinary import duties have to be deducted in arriving at a net export price.

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[2] The export-oriented nature of many industries in South-East Asia means that constructed prices are likely to be used.

After the normal value and export price have been calculated, the two must be compared to arrive at the margin of dumping. Several factors have to be considered in making this comparison, and Community law allows a limited number of adjustments to be made to take account of differences which may exist between the two kinds of sales. Adjustments may be made for three categories of differences: physical characteristics, import charges and indirect taxes, and certain selling expenses (transport, packing, credit, warranties, salesmen's commissions and salaries, etc.) Several criticisms have been made in this context because of the Community's refusal to make adjustments for differences between domestic and export sales in the quantities which are sold and the level (e.g. to wholesale or direct to retail) at which the sale takes place. The Community view is that different quantities will automatically be compensated by the different transport rates applicable. Furthermore, it denies that the different levels of sale have any direct relationship to the price. However, what the Community legislation fails to take account of is the way in which such different levels of sale can often constitute separate markets. Faced with a practical situation, the EEC Commission has acknowledged that OEM sales are different from others.

The most bizarre aspect of the rules on comparison arises when the exporting company uses local selling organizations in both its home and Community marketing. Taking a literal interpretation of its legislation, the Community calculates the costs of the two operations in quite an asymmetrical fashion, deducting costs from the export sales which are not deducted from sales made at home, and thereby creates an artificial dumping margin. Only companies which have significant selling organizations with the Community are hit by this rule, and to date that has meant only large Japanese corporations. Although frequently criticized by Japan, no formal complaint has ever been pursued against this under the GATT disputes mechanism.

Once the export price and normal value have been determined on a comparable basis an anti-dumping margin may be calculated. This is not done by simple averaging. Instead the amounts are reduced to zero, and only then is an average dumping amount determined (weighting by quantity or volume). This "zeroing down" of negative dumping amounts (which also happens in the United States) means that, wherever export prices vary significantly, a finding of dumping is almost inevitable (unless home-market prices are markedly below export prices). Even if individual domestic prices vary alongside export prices the fact that they are averaged before they are contrasted with those export prices means that the latter will sometimes be above and sometimes below the normal value.[3] The dumping margin is assessed as a percentage of the c.i.f. price. It can thereby easily be set as an anti-dumping duty imposed on imports in addition to ordinary customs duties.

According to the General Agreement rules, a finding of dumping is not of itself sufficient to justify the imposition of anti-dumping duties on imports. There is a second vital requirement: it must be established that the dumped imports are causing injury to an industry in the importing country. The Community regulation reflects this principle: there must be injury to a domestic industry, and it must have been caused by the dumped imports. The General Agreement and community rules enlarge on this principle by listing the factors to be taken into account. For example, imports are likely to have been the *cause* of injury if they have increased in amount and if their prices are undercutting those of the domestic industry. The injury itself is to be assessed in terms of such factors as profits, utilization of capacity, and market share.

The exporter is at a considerable disadvantage in the application of this part of the law. Firstly, the issues are inherently imprecise. Secondly, he has no access to the vital information upon which the Community makes its decision: the financial and accounting data of the firms within the Community who say they are being injured. However, through their own marketing experience, exporters can sometimes make useful arguments on the proper definition of the industry, and upon other factors which might be causing injury. Generally speaking, however, it is possible to spend a great deal of money on economic research into the condition of the domestic industry without having much influence on the outcome of the investigation. The fact that the Community is largely beyond supervision in making injury findings does not make the outcome of its investigations a foregone conclusion. A significant minority of cases end in findings of "no injury".

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[3] This practice is now the subject of a complaint by Hong Kong under the GATT Anti-Dumping Code procedures.

II. INVESTIGATION PROCEDURES

Anti-dumping proceedings are commenced following a complaint by the relevant domestic industry. The actual investigation is in the hands of the EEC Commission, and once a complaint has been accepted, the complaining industry has very little to do (except provide information relevant to the question of injury). Unlike the United States procedures, neither side has access to the other's confidential information.

A notice of initiation of an investigation is published in the Official Journal of the European Community (C Series). Following a GATT recommendation, the notice gives interested parties 30 days in which to make their views known. Shortly after the publication of the notice, the Commission sends individual notifications and questionnaires to those interested parties of which it knows. These include those exporters whose names have been given it to by the domestic industry, or with whom it is already familiar. However, the fact that an exporter is not sent a questionnaire is not a ground for exemption from an eventual duty. Exporters are therefore well advised to get a copy of the questionnaire (but it does not necessarily follow that they are always best advised to answer it). Over the years, the Commission has demanded increasingly detailed kinds of evidence in its questionnaires, and the burden of providing it is often very heavy, particularly since the deadline is so short. For example, it is normal practice to require details of every domestic and Community sale during the reference period, as well as detailed cost information related to individual product lines.

The answers given in questionnaires are verified by visits to exporters by EEC Commission investigators. While having much less time for their work than their United States counterparts, they usually have considerable experience. It would be unwise to imagine that they can be easily deceived. Exporters are under no obligation to provide information or to allow Community investigators to visit their premises. The attitude of the Community to non-co-operating exporters is explained below. Non-co-operation can in some circumstances be a rational policy, but to make the right decision an exporter has to do a great deal of work in a short space of time, and even then there will usually be an element of risk in his choice. Furthermore, there is no guarantee that the Community will not toughen its policy on non-co-operation.

There are specific stages of the investigation at which the exporter may make submissions, and the rules require the Commission to give him advance notice of the decision they propose to take (although at this stage it is probably too late to exert any influence). As already mentioned, the European Court of Justice has certain appellate powers over anti-dumping decisions, but has recently proved unwelcoming to exporters' complaints. In any event, such proceedings take several years to come to judgment.

Where the Community finds dumping and injury, it is entitled to impose anti-dumping duties. As an alternative, it may accept an undertaking from the exporter to keep his export price above a certain level. Such an undertaking should generally be preferable for an exporter since it means that he, rather than the Community, receives the extra amount paid by the importer. This logic should not apply to an exporter who expects to lower his domestic prices (relative to his export prices), since this would remove the dumping margin and thereby entitle the importer to a refund. However, the delays in paying refunds are such that they are usually regarded as windfalls. The Community will only accept undertakings when it thinks their implementation can be adequately monitored (there have been several cases of undertakings being broken). In some instances undertakings are accepted as to the quantity of exports rather than to the minimum price. The imposition of anti-dumping duties is a two-stage affair. The initial investigation leads to "provisional measures" which are then followed (within six months) by definitive duties. The provisional measures also take the form of duties, but the importer can simply present a bond for their eventual payment. It is quite common for the levels of duties to be altered at the definitive stage, and occasionally a previous positive finding may be set aside.

The rules of the General Agreement encourage States not to impose the full margin where that is not necessary to prevent injury and, unlike the United States, the Community regularly puts this policy into effect. For this purpose it calculates a margin of undercutting (which it also had to do as part of the investigation of causation of injury), and if (as frequently happens) this is lower than the dumping margin, the anti-dumping duty is set at this level (also known as a margin of injury). Except in major investigations, the Community gives little detail on the way it calculates the margin of undercutting. This may be because the difficulties are even greater than those affecting the margin of dumping. In particular, since the comparisons have to be made between articles made by different producers (those of the imported product and those of the competing domestic product) much wider adjustments may be necessary. Furthermore, the Community makes the comparison with the "fair" price of the domestically-made goods, i.e. not prices which have been driven down by competition with dumped imports. This may require increasing the actual domestic prices by some factor to allow for a "fair" profit.

The Community will determine a dumping duty for each of the exporters who have supplied information. For all others (those who declined to co-operate or who were ignorant, and those who might commence exporting in the future) the Community fixes a residual duty level, which is almost invariably the highest dumping or injury margin found among those exporters who have co-operated.

Anti-dumping measures most frequently take the form of *ad valorem* duties. However, for homogeneous products such as raw materials, specific duties (e.g. 10 ECU per unit, or per kilo) are often used. Finally, when the duty is derived from a margin of injury, the Community often uses a minimum price system, i.e. the duty imposed equals the invoice price subtracted from this minimum price. It will be appreciated that the type of duty becomes quite significant if the exporter is envisaging increasing his export price so as to remove the dumping margin. It is quite common for exporters to be assigned individual dumping duties (in which case *ad valorem* duties are used and, where appropriate, exporters may be exempted from the duty). Occasionally, distinctions are made between products.

In line with the GATT Code, the Community rules allow for the refund of duties imposed in excess of the actual dumping margin. The calculation of refunds is rather more complicated than might seem the case at first sight. In particular, it raises the question whether the purpose is to compensate the individual importer or to offset the dumping of the exporter. In other words, if some importers have been paying fair prices and others have obtained the goods at dumped prices, should the former be refunded all the duty paid, or only an average which reflects the overall dumping margin. The Community has only recently made its attitude clear on the point, and it appears to favour the second view. The most notable, if not notorious, feature of Community practice in regard to refunds is the appalling delay in their administration. In recent years the average length of proceedings has been about three years. In contrast, the importer is given only three months from the date of import to make his refund application.

A more technical ground for objection has been the practice of the Commission in allowing a refund to importers who are related to the exporters (usually as subsidiaries) only if the import price is increased by twice the dumping margin. Properly considered, this practice should be followed only if the refund is to be passed on to the arms-length purchaser, an unlikely eventuality given the delay in administering the system.

The rules also allow for a review of anti-dumping decisions. This can happen at the initiative of the exporter, but nowadays they occur most frequently as a result of the operation of the "sunset clause". Under this procedure introduced in 1984, duties and undertakings lapse five years after their entry into force or their last modification or confirmation. It is quite common for the domestic industry to request a review at this stage and this can result in the order being renewed.

It is possible to appeal against anti-dumping duties to the European Court of Justice. However, this Court does not concern itself with the minutiae of dumping calculations and, even on general issues of interpretation, has in recent years shown itself to be very sympathetic to the views of the Commission. A proposal to include anti-dumping matters within the jurisdiction of the new Court of First Instance (which would be able to examine the details involved in dumping investigations) has been deferred for two years following heavy lobbying by the anti-dumping division of the Commission.

In 1987, the Community introduced a new element into its anti-dumping law by providing for the imposition of a special charge on articles assembled within the Community from imported components where the same article was already subject to an anti-dumping duty. The object was said to be the prevention of "circumvention" of the original order, and the rules governing the imposition of the new charge implied that the object was to prevent an exporter avoiding an existing anti-dumping duty by dumping components rather than the whole article. However, the Community carefully avoids defining the problem as one of dumping of components. So far only exporters in Japan have been hit by the charge. Unlike the United States equivalent, it does not cover items assembled in a third country, but such items may be caught by anti-dumping duties by application of the rules of origin. As explained below, a GATT panel has recently held that the Community's components rules are incompatible with the General Agreement.

Recently a new phenomenon has arisen in the field of Community trade policy: the aggressive use of origin rules. Under the basic Community rule (Regulation 802/68) a product in the production of which two or more countries have been concerned is to be regarded as originating in the country in which the last substantial process or operation that is economically justified was performed, having been carried out in an undertaking equipped for the purpose, and resulting in the manufacture of a new product or representing an important stage of manufacture.[4]

This principle may be applied to a number of individual products by specific regulations, and a number of such instruments were made in the 1970s. The Commission has recently reactivated this power in regard to integrated circuits (computer chips),[5] and photocopiers[6] (a regulation for printed circuit boards is also being considered) in a way which apparently makes it more difficult for an assembler/processor to give a new origin to the product.

Both of these products are the subject of Community anti-dumping measures against Japan, the significance of which is illustrated by the recent controversy over Ricoh photocopiers. Ricoh, whose exports from Japan incur anti-dumping duty, established an assembly plant in the United States using parts from Japan, and began to export to the Community. The rule introduced in 1989 provided that mere assembly of (imported) photocopying apparatus accompanied by the local manufacture of various subsidiary elements (the harness, drum, rollers, side plates, roller bearings, screws and nuts) would not be sufficient to confer a new origin on the apparatus. In other words, the completed article would be regarded as of Japanese origin, and thereby be subject to the anti-dumping duty.

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[4] Art. 5.

[5] Reg. 288/89, *OJL* 33, 1989, p. 23.

[6] Reg. 2071/89, *OJL* 196, 1989, p. 24.

Similar decisions have apparently been taken regarding Japanese photocopiers assembled in Hong Kong, and (under the general rule) electronic typewriters assembled in Taiwan province of China. The latter gave rise to proceedings before the European Court, which has elaborated the following general principles. A "simple assembly operation" will not confer origin. This would include operations which did not require persons with special qualifications, sophisticated machinery, or specially equipped factories. Apart from this, mere assembly will confer origin if, from a technical point of view and having regard to the definition of the goods in question, such assembly represents the decisive production stage during which the intended use of the parts used becomes definite and the goods in question take on their specific qualities. If the application of this criterion does not lead to a conclusion, the question to be asked is whether all the assembly operations in question result in an appreciable increase in the commercial value ex factory of the finished product. If only two countries are involved, then a figure of less than 10 per cent value added in the country of assembly would certainly not confer origin.[7]

Regulation 802/68 also contains an anti-circumvention rule, which the Court also interpreted. A process of which the sole object is to circumvent the rules applicable to goods of a particular country is to be discounted. The transfer of an assembly operation from the country in which the parts were manufactured to another country in which existing factories are used does not in itself justify the presumption that the sole object of the transfer was to circumvent the applicable provisions unless the transfer of assembly coincides with the entry into force of the relevant regulations. In that case, the manufacturer concerned must prove that there was reasonable ground for carrying out the assembly operations in the country from which the goods have been exported and that it was not for the purpose of escaping the consequences of the provisions in force.[8]

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[7] *Brother International v. Hauptzollamt Giessen*, case C-26/88, (1989) ECR, paras. 16 et seq.

Several member States are unhappy with the Commission's current attempts to tighten origin rules, but the procedure under Regulation 802/68 makes it difficult for a minority of dissatisfied States to block the Commission's proposals.

III. EC ANTI-DUMPING RULES IN THE PERSPECTIVE OF GATT

The General Agreement on Tariffs and Trade is the name of both an international treaty and of the organization which has grown up to administer that treaty and its related instruments. In fact the whole constitutional structure of the General Agreement is a very curious one, but for present purposes it will suffice to regard it as a set of treaty rules constraining what parties may do to regulate trade, and as an organization which supervises, interprets and even extends those rules.

The mechanisms of the GATT, including that for dealing with complaints of infringements, may be operated only by parties (i.e. by States, and the Community, not by firms or private individuals). The procedure for resolving a dispute between two parties involves the creation of a panel of independent members (often diplomats from other countries) which acts somewhat like a court. However, unlike a court, the panel's findings have to be adopted by the contracting parties to the General Agreement. Since these normally operate by consensus, it is possible for the wrongdoing state to block adoption of a critical report. Of course, in doing this it incurs political odium, and this acts as a deterrent.

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[8] *Ibid.*, paras. 26 et seq.

As regards dumping, the General Agreement contains a provision, article VI, which limits what contracting parties may do in imposing anti-dumping measures, both as regards the circumstances in which measures are justified and the form those measures may take. This provision was greatly enlarged by the Anti-Dumping Code concluded in 1968 in the Kennedy Round. A revised Code was agreed in 1979 at the end of the Tokyo Round. It was designed to operate in parallel with the rules on countervailing duties contained in the Subsidies Code which was negotiated at the same time. The Codes are being examined during the current Uruguay Round, and a number of changes have been proposed. Although only a minority of contracting parties are signatories of the Anti-Dumping Code, these include all the significant importing countries who make use of such procedures. In consequence the Code Committee is now the principal GATT forum for discussion of anti-dumping matters.

Although the Community's anti-dumping legislation was largely modelled on the rules contained in the Code, the development and application of those rules have caused several exporting countries to question whether it is properly abiding by all its GATT obligations. The only formal complaint has been the one made by Japan under the general disputes clause of the General Agreement[9] concerning the Community rules on components. The panel has recently decided in favour of Japan. It found that the collection of duties and the obtaining of undertakings regarding origin were internal measures in conflict with paragraphs 2 and 4 of article III; these infringements could not be justified under article XX(d) because they were not designed to "secure compliance" with the obligations imposed by the anti-dumping law or the original anti-dumping order.

A Code panel is at present considering complaints made by Sweden against the anti-dumping action of the United States on speciality steel, and a number of the issues raised have potential implications for Community law, including that of the adjustments made when comparing domestic and export prices.

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[9] Article XXIII.

Although there are many unsatisfactory aspects to the Community's anti-dumping law, the question whether they are also in breach of General Agreement obligations is not always as straightforward as some of its critics maintain. In one respect, however, the critics sometimes underestimate the strength of their case. It is a mistaken perception of the General Agreement in general, and of the Code in particular, to suppose that infringements can only be established in so far as explicit rules are broken. These rules, especially those of the Code, assume others which are not directly stated. Of special relevance to the practice of the Community is the obligation to make a fair comparison of export price and normal value. Article 2(6) of the Code actually states this principle in regard to export and domestic prices, but it surely cannot be denied that it is one which should govern all aspects of the procedure. Nevertheless, some statements of Community law, including some made by the Court of Justice,[10] treat the anti-dumping legislation almost as a collection of miscellaneous obligations, devoid of purpose or connecting principle.

On the other hand, it must be admitted that there are limitations to any attempt to deduce fundamental principles of a General Agreement anti-dumping law. One might expect that, as a sophisticated attempt to provide for an economic phenomenon, this law would reflect a coherent economic theory on the nature of dumping. Such a theory would provide ways of solving problems left unanswered by the rules themselves. Unfortunately, no such theory exists. The General Agreement rules are a compromise between many theories and none. Attempts to introduce a consistent foundation have foundered on the divergent interests and perceptions of the parties. This is true of the original drafting of article VI, and of the negotiations leading to the first Anti-Dumping Code. In the latter, after an initial attempt to broaden the discussion to include questions of general principle, the parties limited themselves to the difficult task of agreeing to a set of detailed rules.

The law is not completely at a loss in the absence of such principles. GATT panels have recognized some general rules of interpretation. In the context of anti-dumping the most important of these is that exceptions should be interpreted narrowly.[11] Since article VI of the General Agreement and the Code create an exception to the obligations on tariffs contained in articles I and II, uncertainties in their interpretation should be resolved in favour of the interests of importers.

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[10] See, e.g. *Canon v. Council*, joined cases 277 85 and 300 85, (1988) ECR, para. 37.

IV. FEATURES OF COMMUNITY LAW AND PRACTICE GIVING RISE TO CRITICISM

1. Options for change: enforcement or amendment

The Uruguay Round has presented an additional forum for pursuing grievances concerning Community anti-dumping rules and their application. Unfortunately, this has led to a significant confusion between areas where the Community is in breach of its existing obligations in the General Agreement and those where such obligations cannot be stated with confidence (although, had those aggrieved chosen to pursue their complaints through the disputes mechanism, this confusion could have been substantially reduced). Nevertheless, the distinction should at least be recognized. If it is not, and if exporting countries bring into the Uruguay Round negotiations matters which, on any reasonable analysis, they are already entitled to under the General Agreement or the Code, then they are likely to suffer two unwelcome consequences. Firstly, the importing countries will be encouraged to make further unilateral interpretations. Secondly, if they are prepared to abandon these interpretations in a new Code, it will only be as part of a bargain in which the exporting countries provide a *quid pro quo*. In fact, since the importing countries have already got most of what they want by unilateral interpretations, the most likely outcome is that no significant changes in anti-dumping rules will be made in the current Round. The one qualification to this view is the possibility that importing countries will want an explicit basis for taking anti-circumvention action, particularly since the findings of the GATT panel reviewing the Community's measures (above).

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[11] See, e.g. Report of panel on the United States customs user fee, L 6264, 1987, para. 84.

2. Evidence sufficient to commence investigation

Article 5 (1) of the Code requires that there be sufficient evidence of dumping, injury and causation. The criticism is sometimes made that the Community commences anti-dumping investigations on the basis of inadequate evidence. In addition, it is said that the accused exporters should be allowed to comment on the complaint before a decision to initiate is made.

Information relevant to the first criticism is difficult to obtain. After an investigation is commenced, the accused exporters are shown the complaint made by the domestic industry, and an outline of its allegations is published in the commencement notice. It is evident that some of the allegations contained in these complaints are wildly inaccurate.

The Commission does not provide the statistics of the number of complaints which it rejects as inadequate. However, since staff shortages have reduced its ability to carry out investigations,[12] it presumably does not commence proceedings unnecessarily. Indirect evidence on this point is also provided by the number of proceedings which are terminated following findings of no injury or no dumping. In the two years ending in September 1989, less than a dozen proceedings were terminated on this basis.

3. Time limits and burden of investigation

The recommendation on time-limits made by the Anti-Dumping Committee in 1983 states that 30 days should normally be given as the period for responding to the questionnaire (counting from the date of receipt, assumed to be one week after dispatch), but that extensions should be granted wherever possible.[13] No rule is stated in the basic Community regulation, but individual initiation notices set a 30-day period. Although the recommendation only concerns the response to the questionnaire, Commission notices of initiation specify that submission of information, arguments and requests for hearings should all be made within this period.

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[12] Commission of the European Communities, *Sixth Annual Report of the Commission on the Community's Anti-Dumping and Anti-Subsidy Activities*, COM(89)106, 1989.

[13] *BISD*, 30S 30.

Fortunately, if the exporter appears to be making efforts to provide the necessary information, the Commission does not normally refuse to accept information presented after the limit has expired. Nevertheless, the exporter is forced into the position of asking the Commission for a favour. It is noteworthy that the Commission investigators are subject to few time-limits, and have been known to take more than a year to make even a provisional measures decision.

The shortness of the time-limits is particularly remarkable when one considers the large amount of detailed information required of exporters. The extent of the Commission's demands often comes as a considerable shock to those caught up in anti-dumping proceedings for the first time. Furthermore, they are reluctant to part with sensitive commercial information (although there is no reason to doubt that confidentiality is properly respected by the Commission). Exporters must give a non-confidential summary of their information, which is made available to other parties. They sometimes give away more than they need in this document; relatively little detail is in fact required by the Commission.

Bearing these considerations in mind, it is puzzling why the exporting countries which are parties to the Code should ever have agreed to such a short time-limit. Its existence undermines any attempt to argue that the Code itself requires more liberal treatment. The period should be at least 60 days. Regarding the other aspect of this complaint - the volume and detail of information demanded by Commission investigators - it is much easier to state the problem than it is to find the solution. Pious statements, such as "unnecessary demands should not be made on companies", would be of little help.

4. Sales at a loss: all products or product-by-product

In deciding whether domestic sales are being made at a loss and may therefore be disregarded as "not in the ordinary course of trade" (in calculating normal value), the traditional practice was to take account of the aggregate of the sales of the like product in the domestic market. However, since 1985, the Community has begun to apply the test when calculating overall normal values for individual models or product lines. The consequence is that domestic prices on those models etc. are sometimes being rejected in favour of constructed prices, in situations where previously (because sales as a whole were profitable) they would have been accepted as the basis upon which to calculate the normal value.

Considering that, as explained below, constructed prices are inherently prejudicial to exporters, the lack of controversy on this change of policy is surprising. The existing General Agreement rules are of such general character that a case of infringement could not easily be made. Nevertheless, the point deserves attention, and the Uruguay Round provides an opportunity for clarification.

5. Normal value in the absence of domestic sales

If there are no comparable domestic sales, the General Agreement rules[14] at present allow an importing country to base the normal value on a constructed price, or on the price of sales of the product to third countries. As already noted, the Community habitually chooses the former alternative; the latter is rejected on the ground that the exporter might also be dumping to third countries. Although initially attractive, the Community's argument loses its strength on closer examination. If all exports of a product are being dumped then either the company is operating at an overall loss - a fact which should be evident from its accounts - or it is cross-subsidizing sales of the dumped product from the profits of other parts of its business.

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[14] Code article 2:4.

However, mere discrimination in profit levels between different products is not dumping. There is no dumping involved in using a profit of 10 per cent on the sales of product A in the home market to subsidize the sales of product B in the Community at a profit of 2 per cent - it has to be shown that the latter sales are actually made at a loss. Thus the level of cross-subsidization necessary to constitute dumping is considerable, and consequently should be easy to detect.

In any event, the Community's rejection of such prices is based on a tacit assumption regarding the reliability of constructed prices. No such assumption is justified: in particular, the fixing of profit levels and overhead costs is a notoriously subjective exercise. Article 2(4) of the Code states that, as a general rule, the addition for profit shall not exceed that normally realized on sales of products of the same general category in the domestic market of the country origin. To these factors must be added the intrinsic prejudice to exporters which results from the Community's use of constructed prices in tandem with the zeroing-down rule, as explained below.

Even without such considerations, it is doubtful whether a wholesale rejection of one of the alternative methods of calculation is entirely compatible with the discretion conferred by the GATT. The Community is in effect arguing that this alternative is inherently unreliable, a conclusion which is hardly reconcilable with its inclusion in the General Agreement rules.

As a consequence, there is a strong case to be made for the argument that the Community is failing in its obligation to effect a fair comparison of the domestic and export sales as required by article 2(6) of the Code. As regards the Uruguay Round, the question arises whether the General Agreement rules should be amended to express a preference between the two alternatives, or to indicate the circumstances in which one or the other should be employed. One possibility would be for the considerations already mentioned to be made explicit in the Code.

6. Timing of comparison

The issue of timing is largely one of the period over which the normal value is calculated: should it be the whole of the investigation period, or should that be broken down into monthly segments. The Commission sometimes adopts one approach and sometimes the other, but in either event the issue receives little attention despite the important implications which the decision can have for the size of the dumping margin. Where the consequences are adverse to the exporter, it is arguable that the Community fails to complement the requirement of the Code that prices should be compared "in respect of sales made at as nearly as possible the same time".[15] In any event, there is a need for guidelines to implement this Code provision.

7. Calculation of dumping margin: "zeroing down"

Along with the issue of asymmetry in adjusting for selling overheads, the "zeroing down" of negative dumping margins is probably the most frequently criticized aspect of the Community anti-dumping practice. In fact, somewhat misleading graphs showing a sine wave intersected by a horizontal axis are a standard accompaniment of most writing on the subject. Despite its notoriety, the practice (which is also followed in the United States) has as yet never been formally challenged in GATT disputes proceedings.

It is worth emphasizing the objectionable features: the practice overstates the difference between the averages of the normal value and the export price. The amount of overstating is directly proportional to the degree of variation in export prices and is inversely proportional to the difference between the two averages. Thus, not only does it exaggerate dumping margins, it does so in ways which are quite arbitrary if not actually perverse. This is clearly a breach of the Code obligation of fairness, already discussed.

The effect of the zeroing-down rule becomes more pronounced as the average from which the normal value is derived is broadened.

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[15] Article 2(6).

Thus it will in general be smaller if normal values are calculated for each month (assuming that home and export sales prices are moving in parallel).

The use of constructed prices, because they are in effect averages, results in a similar distortion. In the absence of zeroing down, and provided that a reasonably long overall investigation period is chosen, the effects would tend to cancel out. The use of month-by-month constructed prices (as frequently happens to fill the gaps in normal values resulting from application of the 5 per cent rule) is peculiarly perverse in all but the very simplest in-and-out manufacturing processes.

8. *Adjustments: restrictive rules*

Comment has already been made upon the restrictions introduced in 1988 on the adjustments which are permitted when comparison is being made between normal value and export price. The problems are most likely to affect large companies with elaborate selling systems in various countries. To date they seem to have been confined to Japan.

Importing countries must be allowed some margin of discretion to decide at what point different types of sales cease to be comparable, and on its face the new Community law is doing no more than that. In practice, however, it is being interpreted not to limit what is comparable, but to deny the right to make appropriate allowances when comparisons are made. In consequence it is in breach of article 2(6) of the Code which requires that due allowance shall be made in each case, on its merits, for the other differences affecting price comparability.

9. *Adjustments: asymmetry*

The criticisms about the Community's curiously asymmetric approach to overheads incurred by selling organization have become so well known that they are regularly discussed in daily newspapers. Surprisingly, there has never been a formal GATT challenge invoking the obligation to carry out a fair comparison between export and domestic price referred to in article 2(6) of the Code. However, the issue is one of limited relevance to developing countries.

10. Adjustments: exchange rates

Export sales prices are often denominated in the currency of the importing country, or in United States dollars. Consequently, when comparison is made with normal value, it is often necessary to carry out a currency conversion. The Community does not call this process an adjustment. However, in the ordinary sense of the word, that is what it is.

The question which can arise is at what point in time the conversion should be made. The Community practice is to use the date of shipment. This appears commonsense until one considers the complications which can arise. In some areas of commerce it is common to conclude contracts, including the setting of prices, well in advance of shipment. Exporters, most of whose bills have to be paid in the local currency, usually want to know the value of such contracts in that currency, even though they have agreed a price in a foreign currency, often dollars. The forward currency market provides a solution since it enables an exporter to know, at the time of the contract, what the value of that contract will be in the local currency. Suppose a contract is being made on July 1st which provides for shipment on September 1st and for payment of $100,000 on that day. The exporter can go to a bank on July 1st and marke a forward exchange contract in which he is told exactly the amount he will receive in local currency when he presents the $100,000 on September 1st, say £160,000. When that date arrives the actual (spot) exchange rate is likely to be different. Thus the spot value of $100,000 might be £150,000. The Commission, which uses the spot exchange rate, would therefore set the export price at a lower level than the exporter actually receives, thereby creating or increasing a dumping margin.

The General Agreement rules make clear that, in calculating the difference between normal value and export price, the prices must be "comparable". Article 2(6) of the Code states that

> in order to effect a fair comparison between the export price and the domestic price in the exporting country (or the country of origin) or, if applicable, the price established pursuant to the provisions of article VI:1(b) of the General Agreement, the two prices shall be compared at the same level of trade, normally at the ex-factory level, and in respect of sales made at as nearly as possible the same time. Due allowance shall be made in each case, on its merits, for the differences in conditions and terms of sale, for the differences in taxation, and for the other differences affecting price comparability.

It is difficult to see how the Commission's approach reflects a "fair comparison".

11. Injury: threshold

Exporting countries and companies often feel aggrieved at findings of injury by anti-dumping authorities because of their apparently arbitrary character. A list of criteria is given, followed by a decision for or against injury which, had it gone the other way, would have seemed just as logical. The solution is often said to lie in more precise criteria or quantification. Whereas progress in this direction is not impossible, the truth is that the issues are inherently imprecise, and that a significant number of cases fall into a marginal area where no decision is clearly right or wrong. The problem is aggravated by the great variety of economic situations presented by the cases. If there were less variety (or more cases) there would be a greater change of similar situations arising and of standards determined in one case being applied to another.

In such circumstances, the most direct path to improvement lies in procedural rather substantive changes. Where the nature of the decision inescapably involves a significant element of discretion, attention should focus on the quality of the decision making. Several factors are relevant. Improvements could be made to the transparency of the proceedings and to the opportunities for granting fair hearing to the parties. More could be done to ensure the independence and expertise of the decision makers. The first is a matter of constitutional and administrative arrangement within importing countries, but the position of the International Trade Commission in the United States provides a useful model. Regarding the second, GATT could take an initiative in promoting meetings and discussions between investigators from the various importing countries.

12. Injury: cumulation

A problem which regularly arises is that of multiple exporters, some or all of whom have only a minimal amount of the importing country's market. Such exporters tend to feel that, even if the finding of dumping is fair, their exports are so small that they cannot be said to contribute to the injury. In many cases it will be true that, had no one else exported to the Community, no injury would have been caused, or none sufficient to justify anti-dumping measures. A particular objection is made against the cumulation of imports of different countries.

Regular protests about cumulation have been made in the Code Committee, and signatories have cast doubt on its compatibility with GATT obligations. For example, Hong Kong has made reference to article 5(3) of the Code.[16] The ad-hoc group set up by the Committee to propose recommended interpretations of Code provisions was unable to agree about cumulation.

Like many problems associated with causation, this one has a potential for considerable philosophical wrangling. The community's approach is, in general, to cumulate ("aggregate") all exports found to have been dumped. However, countries have been excluded when their exports were declining while those of the others were increasing, or were very small (provided they would not increase when other exporters were penalized). The strongest argument in the Community's favour is the difficulty of constructing a fair and viable alternative. To treat any company in isolation would be to discriminate against the rest. All exporters whose exports have been cumulated are "guilty" in that they have all been found to have dumped.

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[16] "An application shall be rejected and an investigation shall be terminated promptly as soon as the authorities concerned are satisfied that there is not sufficient evidence of either dumping or of injury to justify proceeding with the case. There should be immediate termination in cases where the margin of dumping or the volume of dumped imports, actual or potential, or the injury is negligible."

It has been proposed that the special Code rules for developing countries (below) should be adopted. However, to exempt countries having exports falling below a certain level would be, in effect, to sanction quantitative undertakings, something which exporting countries generally dislike (see below).

13. Type of anti-dumping duty

At present, when dumping is established, the choice of the type of anti-dumping duty to be imposed appears to be a matter entirely for the importing country. It is a choice with important implications for the exporting company since, assuming it raises its export prices so as to remove the margin, in one case (minimum price) no extra duty will be payable, whereas in the others (*ad valorem* or specific duty) the importer will have to pay a (higher) anti-dumping duty albeit with the eventual possibility of reclaiming it as a refund.

Not surprisingly, as evidenced by the number of price undertakings which are offered to terminate anti-dumping proceedings, exporters are often willing to avoid duties by raising their prices. It would therefore seem reasonable to have an express preference for this kind of duty inserted into the Code, or at least an obligation on the importing-country authorities to give weight to the exporters' preferences in choosing the kind of duty to impose.

14. Undertakings

As already observed, some Community anti-dumping investigations are terminated by undertakings regarding quantitative restrictions. The Code simply makes no provision for such arrangements, but the existence of detailed rules (article 7) limiting the kinds of price undertakings which may be accepted hardly indicates a permissive attitude on the part of the GATT. Perhaps the problem, as with Voluntary Restraint Agreements, is that the person most interested in the issue has accepted the abuse.

15. "Residual" duties

Considerable criticism has been directed at the Community practice of applying the highest level of duty it determines for any individual exporter as the residual duty applicable to all uninvestigated companies in that country. The rule works harshly against companies which, because of their inadequate resources, could not cope with the burden of supplying information, and on those which were not exporting during the investigation period. In theory, the solution should lie in an application for refunds or review, but in practice neither procedure operates satisfactorily (see below).

Curiously, the Community justifies its policy by reference to the right to make a decision on the basis of the facts available if any interested party refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation (article 6(8) of the Code). In fact, on any reasonable interpretation of the General Agreement law, the need to deter non-co-operation must be accorded some consideration, given the weak starting point of anti-dumping investigators as regards information on the pricing policies of exporters. Until those who voice criticisms offer some answer to this demand, effective criticism of this practice rests on the virtually complete failure of the Community to provide an adequate refund or review mechanism for exporters who are unfairly treated (see below).[17]

16. Refunds

Article 8(3) of the Code provides that

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[17] In one recent case the Community has indicated its willingness to accelerate the holding of a review.

> the amount of the anti-dumping duty must not exceed the margin of dumping. . . . Therefore, if subsequent to the application of the anti-dumping duty it is found that the duty so collected exceeds the actual dumping margin, the amount in excess of the margin shall be reimbursed as quickly as possible.

The most obvious criticism of the Community in this context arises out of the gross delays which occur in the administration of refunds. The result is that an exporter who sells at a non-dumped price can only say to his purchaser in the Community (who nevertheless has to pay an anti-dumping duty) that after two or three years the duty will be refunded. Most trading enterprises would treat such a future potential benefit as a mere windfall, and include the anti-dumping duty as a cost when calculating the profitability of the import. One consequence is that exporters have very little incentive to raise prices in order to remove dumping margins.

The obligation to make refunds is not mentioned in article VI of the General Agreement, and its position in the Code might lead to the conclusion that the topic is one of only ancillary importance. Quite the opposite is the case. To appreciate this point, one has to be aware of the background to the present system for administering anti-dumping duties. This system, by which a duty is assessed on the basis of imports during some recent period, and then imposed on future imports, evolved in several contracting parties during the early years of the GATT. It came to be described as "pre-selection". The alternative was to carry out the whole inquiry in respect of each consignment (or series of consignments) on which it was proposed to impose duties. In either case it was assumed that no duties were due on a consignment which was not dumped. If, under a pre-selection system, duty had been inappropriately collected, it would be rapid.

Not surprisingly, in view of the administrative burden associated with the alternative, when the 1968 Code was drafted it assumed that signatories would operate the pre-selection system. Consequently, the obligation to refund excessive collection of duties was an integral part of the Code, not an accessory tacked on as an afterthought.

These considerations are of relevance not merely to the importance of refunds, and therefore to the seriousness of delaying their administration, but to a more fundamental point regarding their calculation. This is the question whether refunds are calculated from the standpoint of the importer or that of the exporter. The difference is apparent if one considers the situation where an exporter, already subject to an anti-dumping duty, charges dumped prices to one importer and non-dumped prices to another. If the latter claims a refund, is the amount calculated on the basis of the prices charged to him, or on the average of the two sets of sales? It has only recently become apparent that the principle adopted by the Community is the second. It is one which is difficult to reconcile with either the principles of article VI or the wording of the Code quoted above.

On the other hand, although refund calculations should be specific to importers, to guarantee them absolute discretion in this area will be tantamount to inviting abuse. If an importer could pick and choose the consignments upon which he made claims, he could arrange with the exporter to vary the prices so that although on average the margin was unchanged, some sales would be made at nominally non-dumped prices. Another way of approaching this problem would be to apply the refunds on a basis of individual consignments, but to reject the nominal invoice prices as unreliable if there was evidence of such collusion between importer and exporter.

17. Review

The provisions for review in the Community legislation are such that, on their face, they appear to follow the requirements of article 9(2) of the Code. However, an examination of the statistics shows that the number of reviews commenced at the request of exporters is only two or three a year. Such a low figure suggests that the system is not operating adequately, even if the precise reason is not apparent.

Although not inherently unreasonable, and arguably within the administrative discretion which parties to the Code should be accorded, the one-year delay period seems an unfair obstacle to a new exporter who wishes a duty to be assessed for his exports. In a recent case the Community has indicated a willingness to circumvent the barrier, and this approach should be explicitly reflected in the law and included in the GATT Code.

18. Retroactive duties

Among the amendments made to the Community legislation in 1988 was a new, and quite vague power to impose additional duties retroactively when it is found that the cost of existing anti-dumping duties has been borne by the exporter. The power, which has not yet been used, appears to be principally directed at related importers. There is little indication of the procedures which are to be followed, and in particular whether consignments will be considered individually, or whether a decision will be made on the basis of an investigation period. In the light of the past experience of the Community in making unexpected interpretations of apparently insignificant legislative provisions, the broad potential of the new rule deserves close attention.

19. Treatment of developing countries

Article 13 of the Code establishes a special position for developing countries:

> It is recognized that special regard must be given by developed countries to the special situation of developing countries when considering the application of anti-dumping measures under this Code. Possibilities of constructive remedies provided for by this Code shall be explored before applying anti-dumping duties where they would affect the essential interests of developing countries.

By "constructive remedies" the Code is presumably referring to price undertakings.

This obligation has been interpreted by the Community in one investigation as requiring that the stage of development of exporting countries should be taken into account when examining what measures are most appropriate in a particular case, but should not determine whether or not it is appropriate to take protective measures at all. It was hinted that the undertakings accepted from the exporters took account of article 13. In another instance, the Community invoked this provision in refraining from definitively collecting provisional duties in regard to the exporters from developing countries.

One way in which special consideration could easily be given to developing countries would be to introduce a rule into the Code to exclude them from cumulation when determining injury (see above). This would have the effect in most cases of excluding them from the scope of anti-dumping duties.

Perhaps the most relevant fact in this context is that until now, apart from the newly industrialized countries of East Asia, the involvement of developing countries in Community anti-dumping proceedings is rare, and many have entirely escaped its operation. This situation could change, and certainly would do so if the proposal to remove the Multi-Fibre Arrangement was put into effect and quantitative restrictions on textile imports were removed.

20. Anti-circumvention

As already noted, the Community's anti-circumvention rules have been found by a GATT panel to be in breach of article III of the General Agreement, and not justified by article XX(d). The panel issued no general condemnation of anti-circumvention measures, and in particular did not consider whether article VI itself allowed action to be taken. However, its restrictive interpretation of the phrase "necessary to secure compliance" in article XX(d) will undoubtedly influence the course of negotiations during the Uruguay Round, and strengthen the bargaining position of the exporting countries. It is difficult to see how the Community could continue to take measures of this kind without major changes to its legislation.

In general, it would seem that the only measures compatible with the General Agreement would be the ones which took the form of action against dumped components, with the importing countries arguing for relaxation of the ordinary safeguards when there was reason to assume that a previous practice of dumping was being continued in another form. This is effectively the nature of the present United States legislation (which is not to say that every aspect of that legislation is compatible with the General Agreement). Exporting countries should recognize that not all the rules enshrined in anti-dumping laws are required under the General Agreement obligations, so relaxation would not *per se* involve infringement.

Another point to be borne in mind is that the basis of the importing countries' case is that large exporting companies can shift their operations between different centres while maintaining the same price-discriminatory policies. If this is so there is no justification for extending anti-circumvention measures to components produced by independent companies, simply because they share the same country of origin. Nevertheless, this is a feature of both the Community and the United States legislation.

21. Origin rules

There is no explicit rule in the General Agreement constraining the freedom of action of contracting parties regarding rules determining the origin of goods. The anti-dumping rules in the Agreement necessarily presume the existence of some principles by which origin is determined and, in doing so, implicitly create constraints on those principles. Consequently, it can be plausibly argued that these rules may not be circumvented by manipulation of origin rules. Furthermore, in the case of obvious abuse, it should be possible to invoke the non-violation aspects of article XXIII.

Nevertheless, the weakness of the General Agreement in this area cannot be denied (nor is greater assistance available from the Kyoto Convention). Indeed, it is arguable that at present the Community law itself provides more effective limitations. The individual Community origin regulations must fit within the general principle of "substantial process or operation" contained in Regulation 802/68. On an earlier occasion, when highly restrictive legislation was introduced for zip fasteners, the new rule was successfully challenged before the Court of Justice. It remains to be seen whether a corresponding attack will be mounted against any of the latest wave of regulations.

At the level of the General Agreement, the emphasis must lie on reform. The parallel topics of customs classification and valuation provide an obvious model: the general principles could be included in a GATT Code, and the detailed technical matters could be dealt with by the Customs Co-operation Council. Although the matter has recently come to public attention in the context of anti-dumping procedures, this is only one area in which origin rules operate. In fact, it would be a serious mistake to approach the reform of these rules from this direction because of the distortions which this would introduce in the attitudes of those engaged in negotiations. The subject is an inherently difficult one, and the difficulties are aggravated by the variety of the solutions adopted by existing national systems. Effective international regulation is long overdue in this area and it is good that the matter has, tardily, come before the Uruguay Round negotiators. However, the first subject of those negotiations should be the general principles appropriate to origin rules, and only after agreement has been reached on these should consideration be given to how those principles might be protected from abuse by national anti-dumping regimes.

"1992", TRIMS AND THE URUGUAY ROUND

Rodney de C. Grey[*]

INTRODUCTION

This paper attempts to comment on and assess the proposals advanced in the Uruguay Round (UR) regarding trade-related investment measures (TRIMs), focusing particularly on how the evolution of the European Community's (EC) "1992" project may shape EC's negotiating position on this issue. The paper also examines the probable impact of these developments on the proposals of other major negotiating countries, and then considers what implications this may have for the positions of developing countries, especially in the Asian region.

Section I traces the origins of the proposal to negotiate rules on TRIMs under the General Agreement. Section II briefly discusses the "1992" project of the EC, attempting to situate EC's proposals on TRIMs. Section III examines these proposals. Section IV discusses a number of other related issues that have become prominent in the Uruguay Round. Section V concludes by examining the implications of these positions and issues for developing countries.[1]

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[1] In the preparation of this paper, the writer has particularly considered the following documents:

(1) GATT, Contracting Parties, *Report of the Panel on "Canada, Administration of the Foreign Investment Review Act"*, *BISD*, 30th Supplement, pp. 140-68.

(2) "Trade Related Investment Measures", in "Mid-Term Review Agreements" *News of the Uruguay Round*, No. 27 (24 April 1989), p. 23.

(3) Various submissions in the Negotiating Group on TRIMs, including those by the European Communities, United States, India and Japan

(4) OECD, *Investment Incentives and Disincentives: Effects on International Direct Investment* (Paris, OECD, June 1989).

(5) USITC, *Foreign Investment Barriers or Other Restrictions that Prevent Foreign Capital from Claiming the Benefits of Foreign Government*

I. GENERAL AGREEMENT AND TRIMS: THE BACKGROUND

We should first note the origins of the proposal to negotiate General Agreement rules on TRIMs. The proposal derives from the United States Administration's growing concern, in the early 1980s, with attempts by a number of countries, e.g. Canada and Mexico, to negotiate undertakings (or "performance requirements") when foreign investors sought to establish manufacturing facilities or take over or buy into existing domestic manufacturers. The United States had long accepted, as a practical matter, that governments, in exercising their "sovereign right to regulate foreign direct investments" (to use a phrase from the report of the GATT Panel which enquired into Canadian investment policy) might impose conditions on such investors, including conditions regarding location, employment, procurement of materials and components, exports, and degree of local participation in ownership and direction.

Some of these investment-policy rules might be worked out in the context of granting permission for investment to take place; others might evolve in the context of "incentives", such as subsidies to encourage foreign investors to locate in particular regions. (It is to be noted that a recent EC submission to the negotiating group on TRIMs makes it clear that the issues of subsidies to investment falls outside the terms of reference of the Group.) That developing countries might impose conditions on direct investment, as a matter of development policy, was a long-established and accepted practice. United States firms and other firms controlled in developed countries might object to such requirements in particular cases, or in regard to particular countries, but in the general case, such requirements could be accepted as the price to be paid by the investor for the opportunity to make high returns in the often heavily protected domestic markets of developing countries.

Programs, USITC 2212, August 1989.

(6) Various publications of the United Nations Centre for Transnational Corporations.

As for other developed countries, potential United States investors were frequently sought out, and on many occasions their decisions to invest in, say, an EEC member state were the subject of detailed negotiations involving subsidies (including tax concessions), long-term agreements on supply of items such as electricity, and other concessions and no doubt involving undertakings regarding employment, research activities, local content to be achieved, etc. by the potential investor. In some particular cases the proposed United States direct investment in manufacturing enterprises in the EC may not have been welcomed because it opened the prospect of new competition within the European market for established European producers. There was also concern, in the 1960's particularly, that foreign-controlled manufacturing enterprises could compete unfairly by importing components at marginal cost from their parent firms - a type of so-called "hidden dumping". Some European countries, notably France, enacted provisions in their anti-dumping systems directed at such dumping. This issue was explored in the GATT, before and during the Kennedy Round, which produced the first Anti-Dumping Code.

United States business firms had, however, become accustomed to being able to invest without conditions in a wide range of types of business in Canada (although there were limits on foreign participation in some sectors, e.g. banking and mineral projects); accordingly, the attempt by Canada to impose requirements on new foreign direct investment, as an administrative practice under its legislation (of 1973) governing foreign investment, was considered objectionable by some United States business interests.

Their objections were conveyed to the Administration in Washington, which addressed the issue both in regard to Canada (which gave rise to a complaint and a Panel in the GATT) and in regard to other countries, such as Mexico. The United States Administration, in the period leading up to the Uruguay Round negotiations, carried out an investigation of these "performance requirements"[2] and received representations about them. In parallel, members of the United States trade bar also addressed the issue. One may assume that some had clients who objected to having their freedom of action curtailed by Mexican Government or Canadian Government requirements.[3] It was argued, generally, that performance requirements were inconsistent with article III of the General Agreement (the "national treatment" provisions), and that the requirements to export fixed quantities or proportions of production might (particularly if some subsidy were involved) constitute an export subsidy prohibited under article XVI of the General Agreement and under the Tokyo Round Subsidies Countervailing Measures Code. It was also argued that a useful way to come to grips with the problems raised for potential investors by performance requirements was to negotiate rules in so-called "bilateral investment treaties" (BITs). In 1982 the United States Administration, i.e. the United States Trade Representative (USTR), announced a prototype BIT which was addressed, *inter alia*, to the issue of performance requirements. Minimum export requirements and domestic "content" requirements would be prohibited under such a treaty.[4] In parallel with developing this bilateral treaty approach, TRIMs was placed on the Uruguay Round agenda.

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[2] United States Department of Commerce, *Incentives and Performance Requirements for Foreign Direct Investment in Selected Countries*, Staff Report, 1978.

II. "1992" AND TRIMS

The purpose of this paper is not to explore in any great detail the general issue of TRIMs in the UR, but more narrowly, to consider how the "1992" initiative of the EC may affect developing-country interests in TRIMs. We should therefore define "1992". Essentially, the "1992" project is a set of detailed proposals, to be enacted into EC law (i.e. Community law) by 1992, which together will go some way in creating a full economic union among the signatories of the Treaty of Rome. A full economic union, in terms of legislation, institutions and policies, could not be created quickly, even as between the original six signatories of the Treaty, in 1957. The reasons are various. For example, in some countries there is concern that the sovereign rights of democratic governments to prescribe and proscribe in specific areas will be over-ridden by the decisions of what are perceived by some to be no more than an undemocratic, uncontrolled technocracy in Brussels. Some critics of "1992", from this point of view, would wish to see the European Parliament strengthened, genuine EC-wide political parties created, the European Court's proceedings speeded up, and the Brussels Commission made more evidently subject to effective political control. In some areas of economic activity, the movement towards an EC-wide regime is opposed by what are essentially protectionist sentiments made effective by various restrictive business practices; this is evident in such sectors as insurance, to take an example from the services sector, and in automobiles where there are substantial differences in prices for the same make of automobile in the various member States. Despite these obvious obstacles, the Commission has formulated a substancial series of measures, which it proposes to enact by 1992 (during the life time of the present Commission) and which, together, would move the EC a very long way from being merely a customs union and an agricultural regime to being an economic union. The formulation of these measures began with what was called the "Single European Act", which became effective after ratification by member States, in 1987. " 1992" involves a series of proposed directives by the Commission; each one requires detailed discussion and each one will have the effect of moving the member states towards the goal of the Rome Treaty - to create "an even closer union among the peoples of Europe".

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[3] See, for example, Claude G.B. Fontheim and R. Michael Gadbaw, "Trade Related Performance Requirements Under the GATT-MTN System and United States Law", 14 *Law and Policy in International Business*, No. 1, 1982, pp. 129-80; Mark P. Jacobson, "Note: Mexico's Computer Decree: The Problem of Performance Requirements and a U.S. Response" 14 *Law and Policy in International Business*, No. 4, 1983, pp. 1159-95.

[4] For a comprehensive discussion, see Kathleen Kunzer, "Recent Development, Developing a Model Bilateral Investment Treaty", 15 *Law and Policy in International Business*, No. 1 (1983), pp. 273-301.

None of this is, of course, occurring in a vacuum, and indeed the context in which "1992" is being developed is changing rapidly. The most obvious change in context is the complex of developments in the Soviet Union and in the socialist economies of what was once considered to be Central Europe. A less important change in context - much less important - is the growing opinion in the Western European states *not* members of the EC (the EFTA countries) that they should seek closer working arrangements with the EC institutions, and have more detailed agreements with the EC than the present "free-trade area" agreements - that is, preferential tariff agreements - covering industrial goods only. A third change of context is the emerging role, in trade and in investment, of certain non-European, non-North Atlantic countries

- notably Japan, but also the Republic of Korea, Taiwan and Singapore. Investment by Japan in Europe is already of some importance in the EC, and member state governments (as well as the Commission) are concerned as to the terms and conditions (i.e. what performance requirements) under which such investment is to be welcomed, or even competed for. In this complicated and rapidly changing, uncertain context, EC relations with developing countries are clearly a second order issue, not a first order issue - and within the range of developing countries the EC will, obviously enough, be primarily concerned with its Lomé Treaty partners.[5]

The main conclusion which emerges from an examination of recent EC decisions on particular subsidy cases, and indeed from the EC submission to the UR negotiating group on TRIMs, is that the EC will remain primarily concerned with reducing or at least bringing under control the use by member States of subsidies and other incentives to foreign direct investment, which, in conjunction with the acceptance by the business firms concerned of performance requirements, that is, undertakings to the member States, which may effect trade and therefore may distort competition within the Community. But as between the EC as an entity, and other countries such as the United States and Japan, the EC is not likely to be willing to accept obligations which substantially limit its existing rights, and the ability of member States, to influence the conduct of foreign-controlled corporations (and indeed, of domestically-controlled corporations) proposing to manufacture products in the EC in competition with established EC firms. The most obvious industry example is the automobile industry. Here it appears that the individual member States (United Kingdom, France) have negotiated local content obligations and other TRIMs with foreign automobile firms in return for incentives to investment.

Another conclusion that may be evident from the submissions to the UR negotiating group is that, although the issue is on the UR agenda primarily at the urging of the United States, most TRIMs, in the EC at least, are directed at Japanese direct investment. Given that Japan has been investing, and is likely to continue to do so, more heavily in the Asia-Pacific region than in the EC,[6] countries in that region may wish to enquire into the EC use of TRIMs, and to consider to what extent they may wish to model their policies on EC and member state policies and practices. They should approach the TRIMs discussion in the UR from this point of view.

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[5] The literature on "1992" is substantial; the writer has found the following particularly helpful: United States International Trade Commission, *The Effects of Greater Economic Integration Within the European Community on the US*, US ITC 2204, July 1989; Commission of the European Communities, *Research on the "Cost of Non-Europe"*, particularly Vol. 1: "Basic Findings" (EC Commission, 1988); Stanley Hoffman, "The European Community", *Foreign Affairs* (Fall 1989); Giovanni Agnelli, "The Europe of 1992", *Foreign Affairs* (Fall 1989).

III. EC TRIMS PROPOSALS

We should note at this stage more precisely what it is that the EC proposes in the Uruguay Round TRIMs discussion. The first, and one of the most important, considerations in the EC submission is that any TRIMs agreement should be based on an examination of the existing GATT articles and should focus primarily on those investment measures which overtly and directly distort trade. Other investment measures, which "do not have the same direct impact on trade" are to be addressed in a sort of "catch-all" provision under which signatories "should avoid causing . . . nullification and impairment of any benefit framed in such terms would add any rights not now available under GATT Article XXIII. The EC proposes eight types of investment measures which are "directly trade related". There are local-content requirements, manufacturing requirements, domestic sales requirements, trade-balancing requirements, exchange restrictions, product-mandating requirements, "manufacturing limitations with regard to components", and export-performance requirements. The following are comments on these types of measures, in the context of the EC submission, from the point of view of developing countries.

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[6] See, for example, Jurek Martin, "Rapping the U.S. over the knuckles", *Financial Times*, 17 October 1989: "Last year, for example, Japanese investment in Indonesia, Thailand, Hong Kong, South Korea, Taiwan and India was, *in each case, higher than in France or West Germany*." (Emphasis added).

(i) Local-content requirements

The EC submission notes that the Panel on Canadian investment arrangements advised that a requirement imposed by the government of a host country on any firm to purchase goods of local manufacture rather than imported goods (in order to achieve a stated "local content") was contrary to the national treatment provision of article III of the General Agreement. The EC submission argues that "a requirement which would stipulate that goods should be purchased on a competitive price, quality and delivery basis, without a requirement of a specific origin of these goods, would appear to be in conformity . . ." with article III. These propositions should be considered in the light of the following: first, the EC Commission has attempted, in relation to the application of anti-dumping duties, to secure undertakings as to imported content from certain foreign firms assembling products in the EC using imported components. Second, the issue of what EC content is required for automobiles assembled in the EC by non-EC controlled firms (i.e. Japanese firms) to be considered to be of EC origin has been and is likely to continue to be of considerable importance in the application of EC auto import policies. The position of some member States is that vehicles assembled in other EC States by certain foreign-controlled firms are to be counted as "imported", for the purposes of calculating import quotas; the proposal obviously turns on the question of local content actually achieved in such assembly. It may be the case that a Japanese-controlled firm assembling vehicles in an EC member State may achieve local content equal to that being achieved by other foreign-controlled vehicle manufacturers in the EC (e.g. Ford?) or by domestically-controlled vehicle manufacturers (e.g. Rover?). Third, it can be assumed that local content levels to be achieved are not absent from discussions between EC governments and investment incentives (as para. 3 of the EC submission makes clear, that issues falls to be addressed in the negotiating group on subsidies). Fourth, one should keep in mind that the rule of "substantial transformation", which in application confers the right of free circulation within the EC of goods assembled in the Community by a foreign-controlled (or domestically-controlled) firm is, in itself, a form of "local content" requirement. As a practical matter, enquiry by the authorities into content achieved is likely to occur only in the case of an incentive having been awarded or in the case of alleged circumvention of an anti-dumping duty. (The same problems arise, of course, not only in the EC but in other jurisdictions.) Fifth, one should note that concern about local content to be achieved is likely to arise if the investment at issue will produce goods which will compete with established production; this is frequently the case in the EC. For many developing countries, the issue may present itself differently, because there may be no domestic producer to be adversely affected. Sixth, one should note the operative word "requirement" in the EC submission; a formal contractual arrangement between an investor and a government is perhaps different from an investor apparently freely volunteering that he proposes to achieve a certain level of local content in a certain period of time. The TRIMs agreement is directed at actions by governments, not actions private firms may decide are in their own interests. On balance, one might conclude that a TRIMs obligation on local content requirement framed along the lines suggested by the EC may restrain the EC and the member States from overtly demanding undertakings from investors to achieve high local content, but it is unlikely that the EC could contemplate completely abandoning the use of content criteria, if only for the reason that most new foreign investment in manufacturing competes with some existing EC manufacturer.

(ii) Manufacturing requirements

These requirements, as defined in the EC submission, are essentially "content" requirements, as the EC paper notes.

(iii) Domestic-sales requirements

It is not apparent to this writer that requirements to sell production from a proposed new facility (as against exporting it) has been an important issue, at least, not in regard to investment in the EC. Many investments in developing countries have been prompted by the desire of the investor to secure sales in a highly-protected, and therefore, potentially profitable market.

(iv) Trade-balancing requirements

As described in the EC paper, this is a requirement which "limits the imports of the investor" to an amount related to export performance. One should note that a more frequent form of such a requirement is what has been called an "exchange link" provision, under which an exporter earns the right to use a proportion of the exchange he earns to purchase imports subject to import controls. The sale of such imports in the domestic market may generate high profits, and there is therefore an incentive to export virtually regardless of price. It should be noted that such "trade balancing" arrangements encourange dumping; such dumping is subject to the anti-dumping provisions and there is thus a GATT-santioned discipline available. One might therefore ask whether, if the exports at issue are not dumped, there is need of any other discipline.

(v) Exchange restrictions

An exchange restriction is a restriction on trade unless it is justified by article XII (and other relevant exceptions in the General Agreement), as the EC paper notes. It is important to keep in mind that certain EC member States have only recently removed such restrictions. It may be that certain member States still retain exchange restrictions which are no more than trade restrictions; however, it is clear that the EC envisages that, as part of "1992", such restrictions will not be applied.

(vi) Product-mandating requirements

Most product-mandating arrangements arise in the private sector, although, in the context of securing incentives, investors may draw attention to the economies to be secured by production rationalization, as between plants in different customs territories. Such "rationalization" is frequently labelled "product mandating".

(vii) Manufacturing limitations with regard to components

Here the EC note argues that such measures, "in order to be operationally relevant, would have to be linked to a restriction on the importation of such components". This might be the case if the "limitation" is in regard to a specified component (e.g. a semiconductor) but in general terms such requireents are merely re-phrased "local content" requirements. What the EC note appears to say is that such a requirement, if *not* linked to a formal restriction on imports, may not be actionable, except under the proposed "catch-all" provisions - which, we have noted, do not appear to extend the scope of article XXIII.

(viii) Export-performance requirements

The EC presentation turns on the proposition that if the production is competitive, "he (the investor) will quite naturally exploit these competitive opportunities and export" and that therefore "export performance requirements" are directed at compelling exports to be made which are not competitive. The EC argues that a TRIMs agreement should prohibit such requirements. Two factual comments may be in order: one is that, given the size, and possible size, of the EC domestic market, such requirements are not likely to be employed by the EC, and the EC is therefore under no disability in wishing to preclude others from imposing such conditions on EC controlled investors; second, the assertion that if the production is competitive the investor will of course seek to export it ignores the fact that transnational corporations have frequently, it is understood, imposed market-allocation arrangements on their affiliates. Indeed, it was this factor which led the Canadians to seek export performance requirements under FIRA, as might be inferred from the relevant Panel report. The failure, against this item in the EC list of TRIMs, to note the practical relevance to TRIMs of restrictive business practices by private firms is merely a conspicuous example of the silence of the EC and the United States on this aspect of the TRIMs complex of issues.

IV. OTHER RELATED ISSUES IN URUGUAY ROUND

Virtually all the issues on the agenda of the UR are inter-related; however, TRIMs is an issue which, from the point of view of developing countries, cannot in any meaningful sense be discussed separately from certain other trade policy issues - and these other trade policy issues may perhaps not be addressed in a satisfactory fashion in the UR. One is the issue of intellectual property rights; the trade related aspect of such rights is indeed on the UR agenda. The other is the pervasive issue of how to control the restrictive business practices (RBPs) of transnational corporations (TNCs). We have noted, in our comments on the EC history of trade-distorting TRIMs, the relevance of RBPs. This subject has, of course, been addressed in UNCTAD and by the UNCTC, but it is not on the UR agenda, and the GATT has never effectively addressed it. We should consider these two matters which, for developing countries at least, may well influence their approach to the various proposals advanced in the TRIMs negotiating group.

A. Intellectual property rights

Although TRIMs - which is under the control of the Group Negotiating on Goods - is a separate issue in the UR, any question of what sort of conditions a sovereign government may seek to impose on a foreign-controlled company seeking to make a direct investment in its territory (if such investment does not fall in a prohibited category as, for example, does telecommunications under United States law) must take into account the other components of the legal regime under which the investment is to be made. Clearly, for many high-technology sectors, the most relevant aspects of the legal system are the laws regarding intellectual property rights (patents, copyrights, etc.) and the tax regime which may apply in relation to the exploitation of such property rights.[7] A number of developing countries have been reluctant to enact legislation protecting the intellectual property of foreign investors; they believe that their various national interests (such as the provision of low-cost generic drugs) is more important than their participation in the international intellectual property rights system. Without expressing a view on the question whether, as a practical matter, a developing country can operate outside that system, it can be argued that to the extent that a country, through the enactment and enforcement of intellectual property rights legislation, does create exclusive rights to exploit such property, such a country should keep parallel powers to establish conditions regarding direct investment, particularly such investment as is designed to exploit such rights created, in part, by domestic legislation. The right to impose controls on direct investment involving technology licencing, the working of patents and copyrights, is in a sense, the obverse of accepting to accord intellectual property rights to foreigners. That the acquisition of an intellectual property right, which confers the right to exploit a monopoly (for a time) may be conditioned by some sort of investment or production requirement is not new; for example, the patent legislation of Canada long provided that it was "an abuse of the patent" to serve the domestic market (for a product covered by a Canadian patent) by importation. The United States in particular, has made both TRIMs and intellectual property issues central to its negotiating position in the UR; that being so, it is important to understand the relevance of TRIMs for the high-technology industries in which intellectual property rights are important.[8]

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[7] It is reported that United States investment in *India* will rise following agreement between India and the United States on tax questions, specifically, the taxation of royalties, copyrights and technical services provided under licensing arrangements. See David Housego, "U.S. Investment in India to Rise after Double-Tax Accord", *Financial Times*, 14 September 1989.

The United States has not faced major problems regarding intellectual property rights in the EC; EC member States have legislation on intellectual property broadly similar to that of the United States (although in the past there were issues between the member states and the United States in regard to the so-called "manufacturing clause" in United States copyright legislation). Thus there is not much to be learned from the EC (and member state) use of TRIMs in regard to intellectual property rights. One might note that the United States did have an issue with one developed country (Canada) over that country's compulsory licencing of pharmaceutical products covered by domestic patents. That issue was resolved, for the present, by Canada's increasing patent protection for pharmaceuticals; in the discussion of the Canada/United States difference of policy, the United States firms with subsidiaries in Canada made it clear they would not proceed with major manufacturing and research projects in Canada unless Canadian law was amended to give them more extensive rights;[9] that is, the private firms advanced "performance forecasts" in the context of intellectual property rights. This case may demonstrate that the complex of issues involving TRIMs and intellectual property rights is not entirely a matter of the difference of interests as between developing countries and developed countries; rather it is an issue between the major industrial entities where research tends to be concentrated (Japan, United States, and EC) and those smaller entities (e.g. Canada) in which the bulk of intellectual property rights created under domestic laws tend to accrue to foreigners.

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[8] See Peter Montagnon, "Patent Law May Be Key to Uruguay Round", *Financial Times*, 17 October 1989.

B. Restrictive business practices

The case can be made[10] that governments need rights to impose conditions on foreign direct investments because there is no *international* legal system which inhibits large transnational corporations from indulging in restrictive practices at the expense of host countries. A transnational corporation (TNC) may quantitatively limit or geographically restrict exports from a plant operated by a foreign-based subsidiary, as we have already noted; it may, as a matter of policy, buy materials and components from its foreign parent or from its traditional suppliers rather than from local suppliers; it may dominate a local market and exact a monopoly price for its products; it may refuse to carry out research and product development locally; it may refuse to license local producers to use its patents, etc. Because of these problems, or perceived problems, governments may impose conditions when granting permission for foreign-controlled direct investment to take place. Governments are aware that their domestic competition law is likely to be less than fully effective in dealing with such practices, and in any event there is no international system of competition law which imposes obligations directly on TNCs or on the home governments of TNCs; no such system in prospect either.

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[9] There is extensive academic writing and newspaper reporting of this issue, which developed over a number of years. It may be clear from the comments in the text that it warrents detailed examination from an international point of view, because that might reveal matters of interest to many countries, particularly developing countries. The comments in the text are based on this writer's involvement in the early phases of these developments.

[10] Indeed, it has been made by India in the negotiating group on TRIMs.

This case is argued in sufficient detail in the Indian paper, and no useful purpose would be served by merely repeating that argumentation here, except to point out that this is an issue which is of more importance to smaller economies than to the larger units such as the EC. However, some observations regarding the broader context of the restrictive business practices dimension of the TRIMs issue may be relevant, as well as some comments on how the EC is addressing such issues. For more than forty years, efforts have been made to devise a functionally effective international regime of competition law or, to use an alternative phraseology, to devise an international agreement that would firmly obligate governments to stop TNCs from employing restrictive practices that have adverse impacts on the economies of host countries. The ultimate objective, one might postulate, would be to create a set of rules that would enable action to be taken under domestic law - that is, an individual could take proceedings in the courts of his country, under an international rule given force in the system of domestic law, against a TNC engaged in a restrictive practice. Such a system of law is far from being realized; there are, of course, separate systems of domestic law addressed to competition, but most of them are far from being effective in disciplining restrictive practices, particularly those occurring outside national jurisdictions.

Moreover, restrictive practices are allowed, or tolerated, in regard to exports, although the same practices may be actionable if occurring in domestic commerce. Thus countries may be exporting, say, components for assembly in a factory abroad controlled by one of its own firms; the domestic legislation of the exporting country on price discrimination is not likely to be applied in regard to such transaction. Such components may be dumped (there is no obligation, in the General Agreement or elsewhere, to prevent TNCs from dumping) or transferred at only marginal direct cost to the foreign subsidiary. Prices in such transactions will serve to provide evidence to the host government that such purchases are cheaper than purchases by the subsidiary of goods produced locally, and therefore, arguably, should be permitted.

Alternatively they may be invoiced at an artificially high price, perhaps by invoicing through a sales subsidiary in a third country, as a means of affecting a transfer of funds from the manufacturing subsidiary to the parent firm and thereby reducing the local tax liability. Domestic competition law does not, in practice, inhibit such anti-competitive practices; as we have noted, there is no obligation on national governments to restrain TNCs from dumping directly, or from making their export sales through sale subsidiaries in third countries. (It should be noted, however, that in Canada and in the United States, for example, there are tax law provisions which can be invoked if firms export at unduly low prices; whether these are effective it is not possible for an outside observer to determine.)

When considering these various practices, and we have cited only some examples, there is a practical problem of securing information on which to base administrative action. As competition law practice in various jurisdictions (including the EC) has shown, it is only if investigators aggressively seize and search through detailed company records that restrictive practices, and inter-corporate transfer pricing practices, can be identified. Obviously, for many countries, and not only for developing countries, the option of using competition law to discipline foreign firms making direct investments is not always a practical approach; accordingly many countries, particularly when granting direct subsidies or tax concessions to foreign direct investment, impose conditions.

The existance of TRIMs in the investment policy of a number of countries is, in a sense, evidence of the failure of the international community to develop an effective, contractual international regime regarding restrictive business practices. The OECD and UNCTAD declarations on restrictive business practices do not have a contractual character requiring countries - in a sense of imposing a firm legal obligation enforceable in law - to impose competition policy rules on TNCs. When the Havana Charter was being negotiated, one chapter (V) was devised concerning Restrictive Business Practices but this was not carried over into the General Agreement (the Havana Charter and

GATT history is adequately described in Jackson's standard text).[11] While the issue has been examined in the GATT, there has never been sufficient agreement on the need, let alone on the details, for a contractual international agreement regarding the restrictive practices of TNCs. Jackson rightly calls this a "lacuna in international cooperation on trade matters" and "the gap in international economic co-operation". The conclusion reached by a GATT group of experts in 1961 still applies today, 29 years later. The GATT group of experts remarked:

> It would be unrealistic to recommend at present a multilateral agreement for the control of international restrictive business practices. The necessary consensus among countries upon which such an agreement could be based did not yet exist, and countries did not yet have sufficient experience of action in this field to devise an effective control procedure.[12]

TRIMs are, in these circumstances, an alternative method by which countries can establish norms for foreign-controlled firms, as well as, of course, for domestically-controlled companies.

One should note, in this context, that the Commission of the EC does have an active competition policy with regard to the conduct of business as between member States. It intervenes in situations in which it appears that anti-competitive behaviour has an impact on trade *between* the member States. The competition policy regimes of individual member States, which operates in parallel, is directed primarily at conduct that affects individual national markets. The EC can, therefore, act against a foreign-controlled firm which, it may be alleged, is in a position of market dominance within the Community and able to indulge in anti-competitive practices; the most noteworthy case of this sort was that launched by the EC against the subsidiary of IBM in Europe. Other countries, such as the United States and Canada, can deploy their competition policy to impose norms on foreign-controlled corporations, as on domestically-controlled corporations, and indeed, to insist on divestiture or partial divestiture when foreign firms take over local companies. It can be argued that, hypothetically, at least, and even in the absence of an international system, an activist competition policy could achieve some of the objectives of TRIMs. As a practical matter, few countries, if any, dispose of the administrative resources to proceed in such a fashion.

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[11] John H. Jackson, *World Trade and the Law of GATT* (Indianapolis, Bobbs-Merrill, 1969), pp. 522-27.

[12] GATT, *BISD*, 9th Supplement, p. 171 (cited also by Jackson, *op. cit.*, p. 526).

One should keep in mind that the item TRIMs is on the UR agenda primarily at the urging of the United States, not of the EC. The United States' perception, as we have noted, is that foreign-controlled firms may establish themselves in the United States without conditions being imposed (aside from those industries where foreign participation is prohibited or limited, e.g. telecommunications, air transport) and, accordingly, United States firms should be able to invest abroad without conditions being imposed (i.e. TRIMs). The United States has a lower level of participation in its industries by foreign-controlled firms than have some other countries (e.g. Canada). Now that there are a number of foreign-controlled firms establishing facilities in the United States, or buying-out United States controlled plants or firms, some attention is being given as to whether the United States should limit such investments, or impose conditions.

It should be noted that what is agreed in the UR regarding TRIMs may well be invoked by the United States, and, of course, the EC, if they wish, in any particular case, to impose conditions on foreign direct investment.[13]

C. Subsidy issues

The issue of TRIMs, in a practical sense, is difficult to disentangle from the problems raised by subsidy practices. The United States is concerned at the impact of TRIMs on its firms making direct investment abroad; it is also concerned about practices which prevent United States firms from securing the benefits of foreign subsidies.[14] Within the EC, the Commission concerns itself with the impact on trade between member States, on competition within the Community, of member States subsidies to firms, including foreign-controlled firms. The

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[13] See Thomas Omestead, "Selling Off America", *Foreign Policy*, No. 76 (Fall 1989), pp. 119-40. The concerns discussed regarding the level of foreign-controlled direct investment seem unconvincing to an observer from a country where foreign-controlled direct investment, notably from the United States, is very high (e.g. Canada).

[14] See USITC, *Foreign Investment Barriers*, *op. cit.*

Commission has required, on a number of occasions, that such subsidies be reduced or eliminated; indeed, disputes over member States subsidy practices are a major matter within the EC (as in the current dispute between France and the Commission on French subsidies to Renault and the current dispute between the United Kingdom and the Commission over United Kingdom support for Rover before its sale to British Aerospace). We can distinguish, as does the EC and United States submissions, between TRIMs imposed as a condition of granting the right to a foreign-controlled firm to establish, to acquire land, to built plant, to import machinery, and TRIMs imposed as a condition of acquiring a subsidy. However, in practice, these are all likely to be negotiated as one package by the investor and the government concerned.

D. Content requirements

As we have suggested above, the most important TRIM employed by EC member States, in the context of awarding subsidies and giving permission for foreign direct investment, is a *local content* requirement. These are highly visible in relation to direct investment in products the import of which are restricted (e.g. automobiles) and in products which are subject to EC anti-dumping duties (or undertakings negotiated in anti-dumping proceedings regarding export prices). The question whether automobiles assembled in the United Kingdom by Japanese-controlled firms, when exported from the United Kingdom to Spain, Italy and France, were to be counted against the import quotas of those member States for automobiles from Japan was extensively reported in the press; in due course it became clear that the United Kingdom authorities had anticipated the problem and had negotiated an undertaking from the Japanese firm concerned to achieve a high level of local content. For the time being, this particular issue of exports to the member States has been resolved, but it is now being advanced in the context of some sort of export limitation or understanding with Japan to replace member States separate restrictive arrangements, as part of "1992". (It should be noted that, in this particular case, the concern with "content" was manifested by individual member States; the formal position of the EC Commission was that the automobiles assembled in the United Kingdom should circulate freely in the Community because they met the requirements of the EC origin rules.)

It is important to understand that a content requirement imposed on a foreign direct investment must be formulated in detailed terms to be effective.[15] It must specify what is to be included in content - only materials and components and direct labour - or overhead, administrative and selling costs as well. It must specify how these items are to be valued: on the basis of prices of goods delivered at the production site (i.e. including transport costs, insurance, duties) or on an f.o.b. basis, or on an ex-factory basis. It must deal with the issue of prices between related firms - are transfer prices based on marginal direct costs acceptable or should there be a calculation of what an arm's length price would be? TNCs control all these types of transactions as between associated enterprises. Unless the content requirements spell out all these matters in great detail the content requirement will be of little meaning. Little information is available about EC member States' actual practice in this regard, but there is no reason to assume that the member States and the Commission do not address the various detailed considerations noted above.

Much attention has been given to the EC Commission application of anti-dumping duties to products assembled in the EC (and the United States)[16] by Japanese controlled plants, which the Commission asserted, were merely "screwdriver" operations, and which lacked sufficient non-Japanese content to be accepted as having EC (or United States) origin. Here the Commission took a view as to what degree of non-Japanese content constituted manufacture in the EC for these particular products - which means free circulation within the EC. Certain other countries with anti-dumping administrative systems have also, of course, had to deal with alleged circumvention of anti-dumping duties by the importation of sub-assemblies or "knocked-down", unassembled goods;[17] such goods can be imported, of course, in separate lots so as to make less evident the existance of a "screwdriver" operation. In this perspective the EC Commission action may not seem unusual, but it is important to recognize that the EC, in dealing with this alleged circumvention, addressed two different criteria; one was the content imported from the company alleged to be dumping; the other was the EC content of the article assembled in the EC. By the terms of the EC paper on TRIMs, the invocation of the latter criteria was questionable.[18]

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[15] This writer drafted the "Canadian content" provisions enacted in regard to the Canadian automotive products programme, in conjunction with the Canada United States agreement on automotive products. These content requirements were set out in a published regulation.

[16] For comments on behalf of Ricoh, the copier manufacturer the United States production of which became potentially subject to EC dumping duties on Japanese-origin copiers, see Ian Rodger, "Japan Machine Imports Must Grow", *Financial Times*, 25 October 1989.

The comments set out above suggest, and the recent EC submission tends to confirm, that the EC will approach the TRIMs exercise cautiously. As we asserted above, the EC will not wish to inhibit significantly the ability of 15 member States (and post "1992", the Commission) to impose appropriate TRIMs on foreign direct investment. This will be particularly the case where the foreign direct investment is in a sector where there is already substantial EC production. Permitting a new entrant (say, a Japanese VCR firm) to establish itself in the Community can be presented as justified if such a production facility can quickly achieve local content not dissimilar from that achieved by EC-controlled firms. One may suppose that the EC will need freedom to impose meaningful local-content requirements in regard to foreign direct investment, even although at the same time it may be opposed to the member States giving excessive subsidies, and thereby securing local content obligations, from such firms. It therefore bears repeating that whatever is agreed on TRIMs, perhaps at the urging of developing countries, will be used by the EC (and perhaps the United States) for their own purposes after the UR. (This may be yet another case in which the results of a negotiation said to be aimed at trade "liberalization" results in an international agreement authorizing restrictive actions which were not widely practised before such agreement.)

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[17] There has been an analogous problem in Canadian customs administration. For many years it has been possible to provide in Canada, by regulation, for special low (or nil) duties on components and materials imported for specific manufacturing purposes. The use of these special provisions was, on occasions, refused by the authorities on the basis that the low local content achieved precluded considering the Canadian assembly of imported components as "manufacturing". The authorities, it is understood, looked to 50 per cent local content as a guideline, but inevitably, there was difficulty of assessing such content precisely.

[18] The writer does not deem it appropriate to comment on the unpublished report of the Panel on this issue, as referred to in *Financial Times*, 13 March 1990.

If we consider this item on the UR agenda in the light of developments in the organization of productive processes, we would have to take account of the fact that the growing use of computers linked by telecommunications system has tended to centralize managerial decision making in TNCs.[19] For United States, EC, or Japanese firms, assembling goods in subsidiary plants in nearby markets (for the United States - Canada and Mexico, possibly Brazil; for Japan - the ASEAN region; for the EC - EFTA, the Maghreb countries, and the Central European States) a calculation has to be made whether components should be shipped (at marginal direct cost) from parent firms to subsidiaries or whether local suppliers of such components should be used. On one side of the problem are marginal costs, plus shipping costs, plus inventory costs; on the other are the rewards of achieving high local content, plus reduced inventory costs. For many United States and Japanese firms in Europe, there must be strong economic reasons for buying components locally, and it may be that the insistance by European governments on obligations to achieve high local content are unnecessary - or necessary only to present the foreign direct investment as politically acceptable.

V. IMPLICATIONS FOR DEVELOPING COUNTRIES

We have noted above that whatever is agreed on TRIMs will be invoked by the EC and member states. We have also noted EC preoccupation with local content, a preoccupation shared by many developing countries. To the extent that developing countries, particularly the more advanced developing countries in the Asian region, may develop lines of production in which subsidiary operations in the EC become attractive, they will become subject to TRIMs by the EC - notably local content requirements if they accept subsidies or if the goods at issue are subject to import limitations (e.g. electric or home entertainment devices). But as in the great majority of cases where subsidiary manufacturing operations are carried out at considerable distance, there will be good economic reasons for seeking out local content.

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[19] The United Nations Centre for TNCs in New York has addressed this development.

As regards direct inward investment, the developing countries have a series of options:

- They can rely on the existing provisions of the General Agreement - article XVIII, particularly para. (2) - to give them sufficient scope to impose such TRIMs as they think necessary.
- They can proceed on the basis that whatever emerges from the TRIMs negotiations will leave them enough scope.
- They may seek a provision in the TRIMs agreement providing for "special and differential treatment" (which will be strongly opposed by the United States, at least).
- They may seek a "reciprocity" rider that could provide that a developing country may, in any event, impose such TRIMs as are employed in the home country of the foreign direct investor. It would appear that either the first or the last option listed above might well be sufficient to meet the needs of developing countries. In regard to the last option, it should be recalled how important Japanese direct investment is for developing countries of the Asian region. They might wish to take into account what TRIMs have in fact been imposed by the Japanese authorities in regard to foreign direct investment.

CANADA-UNITED STATES FREE TRADE AGREEMENT AND ITS IMPACT ON DEVELOPING COUNTRIES

*Peter Clark and Peter Burn**

INTRODUCTION

The Canada-United States mutual trade is the largest between any two countries. The trade in goods and services between these two countries in 1987 exceeded $166 billion. The Canada-United States Free Trade Agreement (FTA) will eliminate, by 31 December 1998, all tariffs on trade in goods and barriers to trade in most services. The Agreement also addresses investment issues between the two countries. While much of Canada-United States trade was tariff-free before the FTA was concluded, there remained large areas of trade which were regulated by significant tariffs and other barriers.

Those areas characterized by high residual tariffs are of interest to a number of developing countries.[1] The FTA has been claimed by the parties to be of significant benefit to third countries, and a useful forerunner or work in new areas being negotiated in the Uruguay Round. In a macro sense, to the extent that the FTA will encourage economic growth within the FTA, third countries should benefit from increased economic activity. Trade policy, however, is a micro issue. The administration of the detail determines and influences trade flows. Therefore, it is important to look behind general claims based on the macro potential at the specific product-related impacts.

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[1] Among these sectors are textiles, clothing, footwear, steel, electrical equipment and a range of prepared food stuffs.

In preparing for an examination of the FTA under article XXIV of the General Agreement or for bilateral discussions with the United States, the FTA must be examined for what it is - a derogation from the usual GATT principle of non-discrimination. It permits the parties to a free-trade agreement to extend preferential treatment to each other on the condition that it leads to the removal of substantially all restrictions to trade between the parties. However, there are potential costs for third countries which must be examined and addressed.

This paper examines the implications and potential impact of the Canada-United States Free Trade Agreement on third countries, with particular emphasis on developing countries. It addresses the agreement as it applies to both countries, but import analysis is focused on Canadian data. The paper is divided into three parts. Section I is a brief synopsis of the FTA, which summarizes the various provisions and points out a number of implications for third countries. Section II reviews the nature of the Canada-United States trading relationship. Section III reviews the impact of the FTA on a sector-by-sector basis.

I. THE CANADA-UNITED STATES FREE TRADE AGREEMENT

A. Objectives and scope

The first chapter of the FTA sets the tone for the Agreement as a whole. The Agreement has liberalized trade not only in goods but in services and in relation to investment matters. It goes well beyond the traditional concept of a free-trade area based only on removal of tariffs and quantitative restrictions. The wide scope of the Agreement is indicated from the outset in the agreed objectives. According to the Parties, the Agreement will, when fully implemented on 31 December 1998:

- Eliminate barriers to trade in goods and services between the two countries;
- Facilitate conditions of fair competition within the free-trade area;

- Significantly expand liberalization of conditions for cross-border investment;

- Establish effective procedures for the joint administration of the Agreement and the resolution of disputes; and

- Lay the foundation for further bilateral and multilateral co-operation and enhance the benefits of the Agreement.[2]

Article 103 of the FTA requires the parties to use *all* necessary measures to ensure compliance by state and provincial governments. This goes well beyond the requirements in article XXIV:12 of the General Agreement and could require a legal (constitutional) challenge.[3] Article 105 requires each Party to extend to the other national treatment with respect to investment and to trade in goods and services.[4] Chapter Two contains definitions applicable to the FTA in general. Other definitions are found in specific chapters.

B. Trade in goods

Part Two of the FTA, Chapters Three through Twelve, deals with trade in goods. It builds on the General Agreement on Tariffs and Trade, its ancillary agreements, as well as other existing arrangements involving the two Governments such as the Harmonized Commodity Description and Coding System, the Canada-United States Automotive Products Agreement and An Agreement on an International Energy Program. Where both Governments were satisfied with existing provisions in the General Agreement and other arrangements, they are incorporated by reference into the Agreement.[5]

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[2] This relates primarily to the development of new bilateral rules about subsidies, countervailing duty, and dumping.

[3] Hopefully progress will be made in the Uruguay Round to develop improved dispute settlement systems.

[4] *Service* is defined in article 201 as including a covered service. The FTA does not cover all services.

[5] For example, the GATT Code on Technical Barriers to Trade is the basis of Chapter Six.

1. Rules of origin for goods

Since Canada and the United States intended that the Agreement primarily benefit the producers of both countries and generate employment and income for Canadians and United States residents, FTA origin rules require that goods traded under the Agreement be produced to a substantial degree or meet a substantial transformation test in either country or both. The origin rules establish the general principle that goods that are wholly produced or obtained in either Canada or the United States or both will qualify for FTA treatment. Goods incorporating third-country raw materials or components will also qualify for area treatment provided they have been sufficiently transformed either in Canada or in the United States, or both, to be classified differently.[6] In some cases, goods, in addition to being classified differently, will also need to incur a certain percentage of direct manufacturing cost in either or both countries, in most cases 50 per cent. This direct cost of manufacturing standard is more difficult to meet than normal origin requirements. It is particularly important for assembly operations to meet these origin tests.

Special rules of origin apply in the textile apparel, automotive and steel sectors and several other sensitive sectors. Apparel made from fabrics woven in Canada or the United States will qualify for duty-free treatment, whereas apparel made from offshore fabrics will qualify for duty-free treatment only up to defined quota levels:

	Non-woollen Apparel	*Woollen Apparel*
	(in million square yard equivalent)	
Imports from Canada	50.0	6.0
Imports from the United States	10.5	1.1

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[6] The rules of interpretation in the annex to article 301:2 make clear that goods that are further processed in a third country before being shipped to their final destination would not qualify for area treatment even if they meet the rule of origin. For example, cloth woven from United States fibres, cut in the United States but sewn into a shirt in Mexico, would qualify for duty-free re-entry into the United States under its outward-processing programme, but would not qualify for duty-free entry into Canada under the Agreement.

Above these levels, apparel made from offshore fabrics will be considered, for tariffs purposes, as products of the country from which the fabrics were obtained. Should Canadian exports to the United States consume more than the quotas set out above (there is no swing between them) of imported fabric, the United States MFN tariff would be applicable, but the exports would be able to benefit from the drawback of Canadian duties paid on such fabric.[7] However, after 1 January 1994, parts and components imported from third countries will no longer be eligible for drawback. This will encourage the use of parts and components sourced inside the FTA. Rules of origin pose an important impediment to developing-country exports of materials, components and intermediate products in the areas discussed below. As formulated, this has effects equivalent to a local content requirement with evident implications for affected developing countries.

United States citrus interests in Florida and Hawaii have been protected. FTA status for juice is gained provided that neither a single juice ingredient, nor juice ingredients from a single third country, constitutes in single-strength form more than 60 per cent by volume of the product. Article 301:3 is also an important impediment to trade in bulk products from third countries. It specifies that "a good shall not be considered to originate in the territory of a Party pursuant to paragraph 2 merely by virtue to having undergone: (a) simple packaging or, except as expressly provided by the rules of Annex 301.2, combining operations; (b) mere dilution with water or another substance that does not materially alter the characteristics of the good; or (c) any process or work in respect of which it is established, or in respect of which the facts as ascertained clearly justify the presumption, that the sole object was to circumvent the provisions of this Chapter". Chemicals and Allied Products are required to meet a 50 per cent direct cost of processing test.[8]

Article 304 of the FTA defines *direct cost of assembling* as the costs directly incurred in, or that can reasonably be allocated to, the production of goods, including:

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[7] Drawback within the FTA is not possible after January 1, 1994 for apparel and citrus products.

[8] Direct cost of processing is a new level of value added requirement.

(1) the cost of all labour, including benefits and on-the-job training, labour provided in connection with supervision, quality control, shipping, receiving, storage, packaging, management at the location of the process or assembly, and other like labour, whether provided by employees or independent contractors;

(2) the cost of inspecting and testing the goods;

(3) the cost of energy, fuel, dies, molds, tooling and the depreciation and maintenance of machinery and equipment, without regard to whether they originate within the territory of a Party;

(4) development, design and engineering costs;

(5) rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes and the cost of utilities for real property *used in the production of the goods*; and

(6) royalty, licensing, or other like payments for the right to the goods.

However, it does not include:

(1) costs relating to the general expense of doing business, such as the cost of providing executive, financial, sales, advertising, marketing, accounting and legal services, and insurance;

(2) brokerage charges relating to the importation and exportation of goods;

(3) costs for telephone, mail and other means of communications;

(4) packing costs for exporting the goods;

(5) royalty payments related to a licensing agreement to distribute or sell the goods;

(6) rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes and the cost of utilities for real property used by personnel charged with administrative functions; or

(7) profit on the goods.

This means that the direct cost of processing cannot include non-production related expenses and profit. So the foreign content is assessed against basic, fully-absorbed manufacturing cost, but not against fully-absorbed cost base, significant portions of which would have to be incurred in the Party.

Materials means goods, other than those included as part of the direct cost of processing or assembling, used or consumed in the production of other goods. *Value of materials* originating in the territory of either Party or both Parties means the aggregate of:

- (a) The price paid by the producer of an exported good for materials originating in the territory of either Party or both Parties or for materials imported from a third country used or consumed in the production of such originating materials; and

- (b) When not included in that price, the following costs related thereto: (i) freight, insurance, packing and all other costs incurred in transporting any of the materials referred to in subparagraph (a) to the location of the producer; (ii) duties, taxes and brokerage fees on such materials paid in the territory of either Party or both Parties; (iii) the cost of waste or spoilage resulting from the use or consumption of such materials, less the value of renewable scrap or by-product; and (iv) the value of goods and services relating to such materials determined in accordance with subparagraph 1(b) of article 8 of the Agreement on Implementation of article VII of the General Agreement on Tariffs and Trade.

The definition of *value of goods* when exported to the territory of the other Party also excludes general, selling and administrative expenses and profits. Section 304 states this value is the aggregate of:

(a) The price paid by the producer for all materials, whether or not the materials originate in either Party or both Parties, and, when not included in the price paid for the materials, the following costs related thereto:

(1) freight, insurance, packing and all other costs incurred in transporting all materials to the location of the producer;

(2) duties, taxes and brokerage fees on all materials paid in the territory of either Party or both Parties;

(3) the cost of waste or spoilage resulting from the use or consumption of such materials, less the value of renewable scrap or by-product; and

(4) the value of goods and services relating to all materials determined in accordance with subparagraph 1(b) of article 8 of the Agreement on Implementation of article VII of the General Agreement on Tariff and Trade.

(b) The direct cost of processing or the direct cost of assembling the goods. Other difficult rules of origin include articles of Plastic and articles of Rubber - Chapters 39 to 40 of the Harmonized System (HS), Footwear (Chapter 64), Steel in HS Chapters 72/73 and HS Chapters 84 and 85 dealing with Machinery and Mechanical Appliances and Electrical equipment, sound and video equipment.

Rule 2 of the Section governing machinery and electrical equipment rules of origin indicates that substantial transformation occurs with a change from one heading to another (other than a parts heading). The provision relating to parts means that if even a small part, say fasteners or a brace, originate in a third country, the finished article will not qualify for FTA treatment. This has led to absurd results and the parties are discussing modifications to the rules of origin.

Because of the wide range of machinery covered, this requirement may create a significant disincentive to sales of materials parts in Canada. The author has experienced a case where an entire assembly has been denied FTA treatment because the screws and fasteners were imported from a third country. We understand that this issue is being reviewed in consultations between the United States and Canadian Governments.

It is not possible in this paper to address all potential problems. What is important to recognize is that *the rules of origin may be a more important determinant than tariff differentials.* The rules of origin will have an adverse impact on third-country exports of parts and components to Canada and the United States.

2. Border measures

(i) Tariffs

Chapter Four of the FTA eliminates all remaining tariffs over a nine-year period. Tariffs will be eliminated by 1 January 1998 on the basis of three formulae. For those sectors ready to compete immediately, tariffs were eliminated on the Agreement entering into force on 1 January 1989. These include: telephone sets, telecommunications equipment, computers and equipment,[9] some pork, some unprocessed fish, fur and fur garments,[10] leather,[11] whiskey, unwrought aluminum, ferro alloys, yeast, animal feeds, vending machines and parts, needles, airbrakes for railroad cars, skis, skates, warranty repairs, some paper-making machinery, and motorcycles.[12] These items were generally low-tariff items of particular to both parties but there will be an impact on third-country trade - e.g. motorcycles from Japan, skis from Europe.

For other sectors, tariffs will be eliminated in five equal steps, starting on 1 January 1989. These include subway cars, chemicals including resins,[13] printed matter, paper and paper products, paints, furniture,[14] explosives, hardwood, plywood,[15] aftermarket auto parts,[16] and most machinery. There is a much broader impact on developing countries in this grouping particularly on parts for machinery, when examined in the context of rules of origin and drawback provisions.

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[9] Already generally duty-free for parts; of interest to developing countries, particularly Singapore.

[10] Of some interest to Hong Kong.

[11] Removal of duties on leather should improve the effective protection of footwear manufacturers who retain MFN tariffs of 22.5 per cent against third countries.

[12] Principal competition is from Japan and United Kingdom. There are small imports from Brazil. There is no production in Canada.

[13] Tariffs on many chemicals will be removed entirely by 1 April 1990.

[14] This is of significant interest to third countries.

[15] Taken together with export controls on logs, this is a significant disadvantage to third countries.

[16] This is potentially a significant advantage for United States producers over developing third countries.

All other tariffs will be eliminated in ten steps, for example: most agricultural products,[17] steel, textiles and apparel, appliances, softwood, plywood, pleasure craft, railcars, and tyres.[18] This category generally covers most high tariff items, and those items of special interest to developing countries.

Annex 401 sets out the schedule of tariff cuts for each product according to its classification in the Harmonized System. If both countries agree, the staging can be accelerated. The first round of accelerated cuts will be introduced 1 April 1990. Agreement has been reached to accelerate removal of tariffs on some 400 tariff items in each country, covering nearly $3 billion in Canadian exports to the United States and about the same amount of United States exports to Canada. Products of particular interest to Canada with 1989 export volumes were methanol ($100 million) photographic film (93 million), aluminium products ($354 million), printed circuits ($303 million) and diesel locomotives ($ 425 million). Accelerated reductions require consensus among Canadian and United States industry. One can detect the influence of TNCs in the process by examining the principal products liberalized. For example, there has been broad agreement on tariff elimination by 1 April 1990 for a wide range of chemicals.

Canada has undertaken to continue providing relief from customs duties on some machinery and equipment and repair and replacement parts for such machinery and equipment not available from Canadian suppliers. The Agreement addresses customs user fees, duty drawbacks, and duty remissions. The United States applies a customs user fee calculated as a percentage of the value of each import transaction. This fee constitutes an additional tariff and increases the cost of exporting, notwithstanding its inconsistency with the General Agreement. Article 403 provides that the customs user fee applied by the United States will be phased out on imports from Canada by 1 January 1994. The authors wonder why Canada settled for half a loaf on this issue. It is a tribute to United States negotiating prowess that phasing out a GATT-condemned measure is seen as a concession. The fee was, however, much more important to Canada than other countries because of the volume of Canadian export to the United States, including many small value shipments, and the volume of duty-free trade from Canada to the United States.

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[17] This recognizes the costs inefficiency of some Canadian processors due to high costs of inputs controlled by supply managements boards.

[18] There is a rationalization of Canadian production underway. This product remains a condidate for earlier removal of tariffs.

Both countries refund the customs duty levied on imported materials and components when these are incorporated into exported goods by way of duty drawback. The Agreement requires that duty drawbacks on third-country materials and similar programmes to be eliminated for bilateral trade after 1 January 1994. There is some debate about whether this restriction involves all trade or only inputs to products benefiting from FTA tariff treatment. Current thinking appears to be that it applies to all trade, whether it qualifies for FTA rates or not. This is a significant disincentive to using third-country party and components.

The potential problem here is more serious with respect to third-country exports to Canada than to the United States for two reasons. First, the United States market is 10-12 times larger than Canada's for most products, so exports to Canada are a much smaller factor in total production than Canadian exports to the United States are for Canadian firms. The United States producers will be the likely source without regard for FTA drawback - unless there are also problems meeting rules of origin requirements. Second, duty rates on third-country imports into the United States are often lower than they are into Canada. The degree of export content in total production combined with lower tariff rates makes it easier for United States producers to absorb the duty which will not be drawn back.

There are two exceptions to the general drawback obligation. Drawbacks will continue to be permitted on citrus products.[19] As well, Canadian manufacturers using imported fabric will be able to apply for drawback of Canadian duties paid on fabric incorporated into apparel, should exports of non-qualifying apparel exceed the duty-free quota.[20]

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[19] Canadian juice producers import most orange juice concentrate from Brazil. They are denied FTA treatment because the dilution and packaging process is in Canada.

[20] The double transformation rules on apparel and textile products are potentially one of the most serious inhibitors to third-country (developing) trade.

Canadian commercial industrial development policy permits remission of customs duty and sales tax on imports by specific companies if these companies meet commitments (performance requirements) related to production, exports or employment. The Agreement provides for the elimination of such duty waivers wherever such waivers are tied to specific performance requirements except for automotive waivers as listed in Chapter Ten and textile/fabric duty remissions introduced before June 1988. These duty remissions are generally contingent in part on using Canadian textile materials in certain volumes.[21]

(ii) Export Measures

In article 407, Canada and the United States re-affirm their GATT obligations not to prohibit or restrict imports or exports of goods in bilateral trade except under strictly defined circumstances. Export restrictions are already prohibited by article XI:1 of General Agreement, but this has been an issue of considerable debate between Canada and the United States. The agreement also precludes minimum export and minimum import price requirements.[22]

Article 408 specifically prohibits export taxes or duties on bilateral trade unless the same tax is applied on the same goods consumed domestically. This is a significant concession for Canada which argued in the Tokyo Round that export taxes were not included in the bindings in their GATT Schedule.[23]

The General Agreement (article XX) recognizes that circumstances may arise where export restrictions are necessary. These circumstances include situations of short supply, conservation of natural resources where domestic production or consumption is also restrained and restrictions imposed in conjunction with domestic price stabilization schemes. Article 409 of the FTA requires that export restrictions for such purposes do not reduce the proportion of the good exported to the other Party relative to the total supply of the good compared to the proportion exported prior to the imposition of the restriction. Any such restriction must not be designed to disrupt normal channels of supply or proportions among specific goods being restricted. It prohibits the use of licenses, fees or other measures to charge higher prices for exports than for domestic sales.[24] The United States view is that the FTA prohibition on export measures prevents these measures from being used to reduce domestic prices to make domestic products more competitive in the domestic market or to provide an export incentive to other products (usually more processed).[25]

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[21] It would appear that on their face such remissions are mixing regulations of a type inconsistent with article III of the General Agreement.

[22] The definition of *performance requirement* will be of interest to participants in the Uruguay Round TRIMs negotiations.

[23] This was one of the arguments put forward by Canada in the Tokyo Round in promoting a "sectoral" approach to trade liberalization which would encourage processing in Canada.

3. National treatment

Chapter Five of the FTA incorporates the fundamental national treatment obligation of the General Agreement into the Free Trade Agreement and through article 502 extends fully these obligations to Canadian provinces and United States states. The obligations with respect to provinces and states go well beyond requirements of article XXIV:12 of the General Agreement.

4. Technical barriers

In Chapter Six of the FTA, Canada and the United States affirm their obligations under the GATT Agreement on Technical Barriers to trade respecting federal governments measures affecting industrial products[26] (agricultural and fish standards are covered in Chapter Seven). The provisions of this chapter do not apply to any measure of a state or provincial government. Canada and the United States will endeavour to make their respective standards-related measures more compatible to reduce the obstacles to trade and the costs of exporting which arise from having to meet different standards. Many standards-related measures are developed by private organizations in both Canada and the United States (such as the Canadian Standards Association or the Underwriters Laboratory) and the two Governments will encourage these organizations to continue to work toward achieving greater compatibility in the standards they establish. These standards will continue to apply against the outside world. To third countries there will be a benefit if they have only to meet one harmonized standard.

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[24] This has become a controversial issue in some Canadian provinces in view of the United States position that it precludes charging Canadian users of, say, electricity, a lower price than customers in the United States.

[25] Statement of Reasons as to How The United States-Canada Free Trade Agreement (FTA) Serves the Interests of United States Commerce Communication from the President of the United States, 26 July 1988.

[26] FTA article 601:2.

The two countries have agreed to recognize each others' laboratory accreditation systems and will not require that testing and inspection agencies and certification bodies be located, or make decisions within its territory in order to gain accreditation. Article 608 provides for further negotiations respecting the compatibility of standards-related measures, accreditation and the acceptance of test data. There will be in North America, as there will be in the Single European Market, a greater harmonization of product standards. There may be benefits to third-country trade - and a basis for further progress in GATT discussions. To the extent that private bodies or trade associations develop these standards there may be problems created by lack of third-party co-ordination. In our view, these moves in the EC and North America are setting the stage for greater harmonization of product standards and eventually for mutual accreditation and acceptance of testing facilities and inspection agencies.

Developing countries should try to broaden such initiatives in the Uruguay Round discussions about technical barriers in the Negotiations Group addressing MTN Agreements and Arrangements.

5. Agriculture

The principal trade liberalizing elements agreed to in the FTA with respect to agriculture are:

- Article 701: prohibition of export subsidies in bilateral trade.[27] Government agencies are precluded from exporting products to the other party at less than their cost of acquisition. This will have little impact on exports from Canada and the United States to third countries.

- Article 701: elimination of Canadian Western Grain Transportation rail subsidies on exports to the United States shipped through Canadian west coast ports. The provision does not affect Eastern shipments through Thunder Bay or exports to third countries through west coast ports. This has been a sore point with United States farmers for a number of years.

- Articles 401 and 702: the phased elimination of all tariffs over a period of ten years (Canada is allowed to restore temporarily tariffs on fresh fruits and vegetables for a 20-year period under depressed price conditions in order to give Canada's horticultural industry an opportunity to adjust). This "snap-back" safeguard clause is to address cross-border trade. It will not likely have any significant impact on third-country trade, but this will depend on the product. This is a safeguard action - which only restores the pre-agreement FTA rate.

- Article 704: mutual exemption from restrictions under meat import laws.[28]

- Article 705: elimination of Canadian import licences for wheat, barley and oats and their products when United States grain support levels become equal to Canadian grain support levels.

- Article 706: the Canadian global import quotas on chicken, turkey and eggs[29] have been set at average levels of actual imports over the past five years. This increases the quotas. As a practical matter, while all countries are eligible to supply under these quotas

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[27] This is an exemption for Canada from the Export Enhancement Program.

[28] Few developing countries export meat to Canada. Most (other than Nicaragua) are precluded from exporting to Canada for health and sanitary reasons.

[29] Justified under article XI:2(c) of the General Agreement in order to re-enforce supply management.

(and eggs have in the past been imported into Canada from South America) virtually all imports are from the United States.

- Article 707: an exemption for Canada from any future quantitative import restrictions on products containing ten per cent or less sugar.[30] Working groups have been established to address (a) animal health; (b) plant health, seeds and fertilizers; (c) meat and poultry inspection; (d) dairy, fruit, vegetable and egg inspection; (e) veterinary drugs and feeds; (f) food, beverage and colour additives and unavoidable contaminants; (g) pesticides; and (h) packaging and labelling of agricultural food, beverage and certain related goods for human consumption.

To the extent that these rules are harmonized exporters will only have to meet one standard for both markets. This provision will not eliminate the need for bilingual labelling in Canada. However, the committee on packaging and labelling of agricultural Food and Beverage products will examine the acceptance of dual declarations of measures (metric and United States units) regardless of the order of the declaration. This committee will also examine metric labelling, ingredient listing on declaration, labelling terminology and definitions, and grading declarations. The committee will review container sizes, including can sizes.[31]

These issues would seem important to those developing-country exporters who are becoming more important exporters of processed food to Canada and the United States.

- Article 708: regulatory barriers resulting from technical regulations have been reduced. Over the next few years, both countries will seek to harmonize such technical regulations.[32]

- Article 710: GATT rights and obligations are retained for all agricultural trade not specifically dealt with in the Agreement.

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[30] This concession was paid for by excluding Canadian beer from the FTA - See article 1204.

[31] Canada precludes the use of certain can sizes for some products.

[32] The FTA defines "harmonize" as make identical.

The main issue which was not addressed was trade in dairy products. The United States has its section 22 quotas justified by the 1955 waiver. Canada's restrictions on ice-cream and yoghurt have been condemned by a GATT article XXIII Panel.

The two Governments agreed that some of the most pressing problems in the agricultural area go beyond Canada and the United States and will need the co-operation of all countries. These are the issues in dispute in the Uruguay Round Negotiating Group on Agriculture. The two Governments have agreed to consult more closely with each other; to take account of each other's export interests with using export subsidies on sales to third markets; and to work together in the GATT to further improve and enhance trade in agriculture (articles 701 and 709).

6. Wine and distilled spirits

Chapter Eight provides for the reduction of barriers to trade in wine and distilled spirits which arise from measures related to their internal sale and distribution. This chapter does not cover beer.[33] Chapter Eight goes somewhat beyond the Agreement between Canada and the EEC to resolve the GATT dispute over the marketing practices of Canadian provincial liquor authorities. Generally, the FTA requires that national treatment be a standard of operating for provincial liquor boards. There are special provisions for the promotion and preservation of small wineries in British Columbia and wine bottled in Quebec which is the only type which can be marketed in grocery stores in that province.[34] This product is generally imported wine, bottled in Quebec. On its face this would appear to be inconsistent with article III of the General Agreement, but Quebec was important in achieving provincial consensus and they were able to extract this important concession.

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[33] A product which would be of interest to Malaysia, Singapore, the Philippines and the Peoples' Republic of China.

[34] FTA article 804:3.

7. Trade in energy

Canada exports more than $10 billion in energy products annually, including oil, gas, electricity and uranium. Billions more are exported in the form of downstream products such as various oil and gas derivatives. These exports are jeopardized from time to time by United States restrictions. This chapter was negotiated by Canada because of a desire for assured secure access to the United States. The United States, for its part, wanted to avoid disruption of supply from Canada.[35]

Chapter Nine applies only to measures related to petroleum, natural gas, coal, electricity, uranium and other nuclear fuels. It does not apply to water (other than electricity generated by hydropower). Some critics of the FTA in Canada have claimed that the agreement does cover water, which is mentioned in Chapter 22 of the Tariff schedules - but water in that context is a beverage, not water for irrigation and other uses. Article 902 affirms Canadian and United States rights and obligations under the General Agreement on trade restrictions in energy products. This includes a prohibition on minimum export or import price commitments. More particularly, the United States has agreed to eliminate all United States restrictions on the enrichment of Canadian uranium and Canada will eliminate the requirement for uranium to be processed before it is exported to the United States.[36] Where either Canada or the United States applies import or export restrictions to energy trade with other countries, it may limit or prohibit the transit of imports from those other countries into its own territory. This may be a contentious issue at some time in the future.

Article 903 restates the obligation in chapter Four not to impose taxes or charges on exports unless the same tax is applied to energy consumed domestically. Article 904 on other export measures restates the obligations of Chapter Four that export restrictions may not reduce the proportion of the good exported to the other Party relative to the total supply of the good, compared to the proportion exported prior to the imposition of the restriction. It also prevents the use of licences, fees or other measures to charge higher prices for exports when such restrictions are used for short supply, conservation or domestic price stabilization reasons. Annex 905.2 will prevent Canadian authorities from pricing energy exports at the "least cost alternative" to United States customers. This creates a North American market in energy. Article 908 provides that Agreement on an International Energy Program overrides Chapter Nine of the FTA.

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[35] The President's transmission of the FTA to Congress notes "Assuring secure supplies of energy at stable and reasonable prices is an essential priority of United States economic and trade policies".

[36] This restriction is arguable inconsistent with the General Agreement and is understood to be the subject of a challenge by the EEC.

The United States view is that the FTA Energy Chapter establishes a framework of free trade principles which should allow over the longer term, the development of a single energy market for the two countries. We expect significant United States investment in Canadian energy development. The United States expects that this will cut their energy import bill.[37] The United States also considers that the FTA will permit them to reduce dependence on less secure sources of imported petroleum. The national security provisions with respect to energy in the FTA[38] are more difficult to use and more specific than those in article XXI of the General Agreement.

8. Trade in automotive products

The automotive industry is the linchpin of Canadian manufacturing and the trade flow between Canada and the United States in autos is enormous. Section XVII of Annex 301.2 provides that all vehicles traded under the Free Trade Agreement will be subject to a special rule of origin. Under the Auto Pact, qualified producers, as long as they meet the safeguards, can import vehicles and parts duty-free into Canada from anywhere in the world.[39] However, for non-Auto Pact producers, fifty per cent of the *direct production costs* of a vehicle traded under the Free Trade Agreement will have to be incurred in North America to qualify for duty-free treatment. Under the rule governing exports to the United States under the Auto Pact, overhead and other indirect costs are included in the requirement that 50 per cent of the invoice price be incurred in Canada *or* the United States. The new direct cost of processing rule is the equivalent of a 70 per cent requirement on the old basis. To meet this test, assemblers will have to source more parts in North America, giving Canadian and United States parts manufacturers increased opportunities. Inevitably this will be at the expense of third-country producers of auto parts. The United States will accord vehicles and original equipment parts exported from Canada duty-free access if they meet the new rule of origin. For northbound trade, Canadian manufacturers with Auto Pact status can import duty free under the Auto Pact, with the old origin rule.

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[37] Statement of Reasons, *op. cit.*, p. 20.

[38] Article 907.

[39] This remission is worth $300 million annually to Canadian Auto Pact.

Chapter Ten provides that each country will endeavour to administer the Auto Pact in the best interests of production and employment in Canada and the United States. It specifies that Canada shall not add to those Canadian manufacturers operating under the Auto Pact and comparable arrangements. This means that new firms who do not qualify for Auto Pact status will have to meet a *de facto* 70 per cent rule. Bear in mind too, that after January 1, 1994 there is no drawback available for third-country parts.[40]

The United States in the President's Communication of the FTA to the Congress clearly states its intention as follows:

> The use of the FTA rule of origin to determine eligibility for duty free entry into the United States under the Auto Pact will benefit United States and Canadian auto parts manufacturers. It will ensure that importers of third country parts cannot use the Auto Pact or the FTA to circumvent our FTA tariffs.[41]

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[40] There are some firms which hope for special remission orders which enable them to import such parts free of duty. However, by article 1002:2, all export based waiver agreements must expire by 1 January 1998. (After 1 January 1989 exports to the United States do not count in calculating duty to be waived.) By article 1002:3, performance-based waiver (value added) must be eliminated on or before 1 January 1996.

[41] Statement of Reasons, *op.cit.*, p. 23.

9. Emergency action

The Emergency Action chapter of the FTA establishes a two-track system under which workers and firms can gain relief from import-related injury while at the same time assuring that the trade expansion created by the FTA will not be suddenly and arbitrarily cut back,[42] while a traditional feature of most trade agreements is an escape clause which enables the parties temporarily to impose restrictions otherwise inconsistent with the Agreement to deal with surges in imports causing serious injury. The two Governments have agreed to stringent standards for the application of emergency safeguards to bilateral trade. This occurs when increased imports from Canada or the United States alone are a substantial cause of serious injury in the market of the other country. The relief available is re-introduction of the pre-FTA or current MFN tariff, whichever is the lower.[43] Under this provision, action can only be taken once against a particular product of the other party.

Additionally, Canada and the United States have agreed to exempt each other from global actions under article XIX of the General Agreement except where the other's producers are important contributors to the injury caused by a surge of imports from all countries. Whether or not Canada and the United States support "selectivity" in the Uruguay Round, they clearly support the approach bilaterally.

Article 1102 contains specific thresholds. Imports below five per cent of total imports will not generally be considered to be substantial and will be excluded from any action. Imports above ten per cent would be considered substantial and would be examined further to see whether they were an important cause of the serious injury from imports. Compensation is provided for under articles 1101:4 and 1105:1.[44]

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[42] *Ibid.*, p 25.

[43] FTA article 1101.

[44] Failing agreement on compensation, there is provision for withdrawal of substantially equivalent concessions.

Under article 1806:1(a) the Commission charged with Administering the FTA is required to refer any dispute relating to safeguard action to binding arbitration. This initiative must be examined and monitored carefully in the context of Uruguay Round discussions on Safeguards. Further, in global invocations, Canada and the United States will tend to benefit at the expense of third countries.

10. Exceptions for trade in goods

The parties have agreed to incorporate the provisions of article XX of the General Agreement and the provisions of the GATT's Protocol of Provisional Application. Chapter Twelve of the FTA also includes a number of miscellaneous exceptions to the trade-in-goods chapter. Both parties agreed to grandfather existing controls on the export of logs.[45] In addition, East Coast provinces will be able to maintain existing provincial controls on the export of unprocessed fish.[46] Article 1204 grandfathers, subject to each Party's GATT rights, existing practices respecting the internal sale and distribution of beer. New practices must meet the National Treatment Standard of Chapter Five.

C. Government procurement

Chapter Thirteen of the FTA broadens and deepens the obligations both countries have undertaken in the GATT Code, commits each country to work toward the multilateral liberalization of government procurement and to negotiate further improvements in the bilateral Agreement once multilateral negotiations are concluded. The chapter increases the amount of procurement open for competition between Canadian and United States suppliers in each other's market. It lowers the threshold from $171,000 (about CDN $238,000 when the Agreement was concluded, now about CDN $200,000),[47] in goods to

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[45] These controls are designed to discourage processing of logs into plywood by Asian countries. They may be inconsistent with article XI of the General Agreement.

[46] Notwithstanding that a GATT Panel has found that West Coast controls were inconsistent with the General Agreement.

[47] 130,000 SDRs.

$25,000 (about CDN $33,000 when the Agreement was concluded, now about CDN $29,000). All government purchases above this new threshold will be open to competition unless they are reserved for small business[48] or excluded for reasons of national security.[49] Also exluded by the United States are:

- Minority Business Set-Asides; "Berry Amendment" Types of restrictions on the Department of Defence (applying to textiles, clothing, shoes, food, stainless steel flatware, certain speciality metals, buses (P.L. 90-500 sec. 404) ships and components thereof) (Byrnes - Tollefson Amendment to DOD Appropriations Act). DOD must purchase these products solely from United States sources;
- Hand tools - there is a 50 per cent preference granted by United States entries not covered by Chapter Thirteen;
- Prison and Blind-Made Goods.
- Cargo Transportation Preferences from the United States perspective.

Nor does the Agreement cover:

- Construction contracts;
- Services contracts - other than those where services are incidental to the purchase of the goods and the value of services does not exceed the value of the goods;
- Purchases by the Department of Agriculture for farm support and human feeding;
- Purchases by state and local governments.

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[48] The government procurement negotiations were of little impact because the United States has retained its Small Business Set-Asides Program and State Provincial procurement is outside the deal.

[49] Under the Canada-United States Defence Production Sharing Agreement, Canada already has preferential access to the United States.

Article 1307 requires renewed negotiations to expand the scope of Chapter Thirteen. These negotiations are required to begin within one year of renegotiation of the Code in GATT. In addition, the chapter makes improvements upon the GATT Code in the area of transparency procedures. An impartial reviewing authority will now investigate situations where suppliers believe they have been unfairly treated and will ensure a timely decision.

For the United States, 11 out of 13 government departments are covered by the GATT Code, with the only exceptions being the Departments of Energy and Transport. A total of 40 governmental agencies and commissions are included. For Canada, 22 government departments and 10 agencies are covered. Department of National Defence purchases of certain defined products, mainly non-military, are also covered. The Departments of Transport, Communications, and Fisheries and Oceans are not included. Canada's access to United States defence procurement of military goods under the Defence Production Sharing Arrangements is not affected by this chapter.

The chapter will give Canadian and United States suppliers advantages against each other in segments of the procurement market which is still closed to third countries. It is a preferential liberalization of the market. Because those parts of the market which are being opened reciprocally by the parties were formerly closed to all countries, there is no question of this liberalization replacing imports from third countries.

D. Services, investment and temporary entry

Part Four of the FTA contains three chapters: services, business travel and investment. Generally, this part of the FTA does not discriminate against third countries in terms of import displacement because Chapter 14 has a grandfather provision which makes application prospective. These new rules will give Canada and the United States, over time, a distinct preference in each other's market unless and until rules of broader application are developed and agreed in the Uruguay

Round. Failing this the United States and Canada are likely to expand the arrangement.[50]

1. Services

In article 1402, the two Governments agree to extend the principle of national treatment to the providers of a list of commercial services established in Annex 1408. With the exception of transportation, basic telecommunications (such as telephone service) doctors, dentists, lawyers, child care and government-provided services (health, education and social service) most commercial services are covered. The obligation to extend national treatment does not mean the treatment has to be the same in all respects. A party may regulate to ensure consumer protection or safety, so long as the treatment is equivalent in effect to both Canadians and Americans.

The obligations are *prospective*, and they do not require either Government to change any existing laws and practices. Rather, the Parties agree that in changing existing regulations for covered services, they will be guided by the obligation not to make any such new regulations more discriminatory than they are already. However, any new regulations for covered services will have to conform fully to the National Treatment obligation. The obligations are meant to extend benefits to Canadians and Americans. Article 1406, therefore, provides that either Party remains free to deny the benefits of this chapter if it can demonstrate that a service is in fact being provided by a provider who is a national of a third country. This is a clear signal that the FTA is preferential to the parties and discriminates against third countries. This is the Services chapter's equivalent of the rules of origin for goods.

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[50] See the United States-Canada Free Trade Agreement Implementation Act - Statement of Administrative Action at 78 79. United States objectives in Section 304(c) of the implementing legislation are (a) the elimination of tariff, non-tariff, and subsidy distortions of trade with respect to developing services sectors not covered under the FTA; (b) the elimination of discriminatory measures "grandfathered" by the Agreement; (c) the elimination of "local presence" requirements; and (d) the liberalization of government procurement of services.

2. Temporary entry for business persons

Canadians and United States residents enjoyed special status for temporary entry into the other country prior to the FTA, being able to move across borders without a visa.[51] However, they did not enjoy special status for immigration purposes beyond temporary entry for business or study purposes. To a great extent, the FTA rules on temporary entry merely codify prior rules, with a few changes that lessen inconvenient border delay and paperwork. No major legislative change was necessary to end the frequent border irritants experienced by Canadian and American professionals which prompted the inclusion of this chapter in the FTA.

It is also important to recognize that the parties to the FTA were careful to limit the circumstances in which the provisions on the temporary entry for business persons would be seen as a precedent.

- The special trading relationship between the Parties;
- The desirability of facilitating temporary entry on a reciprocal basis;
- The need to ensure border security and protect indigenous labour and permanent employment.

The last point reflects the lack of change in Canadian and American rules governing "trades" and "blue collar" occupations.

In order to gain temporary entry under the terms of the Agreement to the United States, Canadian business travellers must qualify for entry generally and indicate the nature of their business (i.e. whether entering as a Business Visitor, as a Professional, as a Trader or Investor, or as an Intra-Company Transferee). In addition, a Professional must be on the list of professions set out in Schedule 2 of the Annex. A Business Visitor must also state the specific purpose of the visit. Seven general types of activities are set out in Schedule 1 of the Annex: Research and Design, Distribution, Growth and Manufacture Production, After Sales Service, Marketing, General Service, and Sales. For other categories of business travellers, current restrictions, such as the need to gain prior approval or to meet a labour certification test, would no longer apply to Canadians.

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[51] Indeed, so long as there was proper identification a passport was not required.

This chapter implies a reluctance on the part of either country to extend such status to professionals from third countries or to broaden the scope of eligible occupations beyond "white collar" positions. It is worth examining the General Agreement compatibility of preferential liberalization when services are linked to goods (including after sales service). Does this liberalization create a *de facto* quantitative restriction on the goods related to the service?

3. Investment

Chapter Sixteen of the FTA establishes framework of principles with the objective that investments flow more freely between Canada and the United States and that investors be treated in a fair and predictable manner.

The basic obligation is to ensure that future regulation of Canadian investors in the United States and of United States investors in the United States and of United States investors in Canada results in treatment no different than that extended to domestic investors within each country. The chapter does not apply to investments related to financial services (other than insurance), government procurement, and transportation services.

This basic principle is qualified on the basis of existing practice, and is translated into the following specific undertakings:

- Article 1602: national treatment on the establishment of new business.

- Article 1602 and article 1607: more liberal rules on the acquisition of existing business. *Canada retains the right to review the acquisition of large firms in Canada by United States investors.* For indirect acquisitions, which involve the transfer of control of one foreign-controlled firm to another, the review process will be phased out over time. These changes to the Investment Canada review process will not apply to the oil and gas and uranium sectors. Article 2005 also exempts "cultural industries", defined to mean an enterprise engaged in publishing, film or video production, distribution sale or exhibition, audio or video musical recordings and broadcasting. This exemption is subject to the right of signatories to take measures of equivalent commercial effect.

- Article 1602: the conduct, operation and sale of United States-owned firms in Canada or Canadian-owned firms in the United States will be subject to the same rules as firms owned by domestic investors.
- Article 1603: limits on certain performance requirements. Both countries have agreed to prohibit investment-related performance requirements (such as local content and import substitution requirements). The negotiation of product mandate, research and development, and technology transfer requirements with investors, however, will not be precluded.
- Article 1605: due process on expropriation in conformity with international law.
- Article 1606: no restrictions on the repatriation of profits or the proceeds of a sale other than those necessary to implement domestic laws of general application.

The undertakings are *prospective* (i.e. applied to future changes in laws and regulations only.) Existing laws, policies and practices are grandfathered, except where specific changes are required (article 1607). The practical effect of these obligations, therefore, is to exempt the oil and gas and uranium sectors from changes to the *Investment Canada Act* and to freeze the various exceptions to national treatment provided in Canadian and United States law (such as the restrictions on foreign ownership in the communications and transportation industries). Additionally, both Governments remain free to tax or provide subsidies to foreign-owned firms on a different basis than domestic firms provided this does not result in arbitrary or unjustifiable discrimination (article 1609) and to exempt the sale of Crown-owned firms from any national treatment obligations (article 1602). Finally, the two Governments need not extent identical treatment as long as the treatment is equivalent (article 1602).

Article 1610 requires that "the Parties shall endeavour, in the Uruguay Round and in other international forums, to improve multilateral arrangements with respect to investment." The FTA is a guide to what to expect from the United States in the Uruguay Round negotiations on TRIMs.

E. Financial services

1. Financial services

Chapter Seventeen of the FTA presents the access that the respective parties' financial institutions have to each other's market. Also, both Canada and the United States have agreed to continue liberalizing the rules governing their respective financial markets and to extend the benefits of such liberalization to institutions controlled by the other Party. This chapter makes significant preferential concessions which grant Canadian and United States financial institutions significant benefits in each other's markets.

Prior to 1978, Canadian and other foreign banks were generally permitted to operate in more than one United States state. Canadian banks had, and still have, retail and other banking operations in a number of states, *unlike many of their United States competitors*. These privileges were subject to review after ten years. These privileges have been "grandfathered" indefinitely in article 1702.

In the area of securities, Canadian banks in the United States will be able to underwrite and deal in securities of Canadian governments and their agents. Canadian financial institutions are guaranteed, by article 1702, that they will receive the same treatment as that accorded United States financial institutions with respect to amendments to the *Glass-Steagal Act*.[52]

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[52] This Act separates commercial banks from the Securities Business. Up until the

Article 1703 exempts United States firms and investors from some aspects of the Canadian "10/25" rule such that they will be treated the same as Canadians. The rule prevents any singly non-resident from acquiring more than 10 per cent of the shares, and all non-residents from acquiring more than 25 per cent of the shares of a federally-regulated, Canadian-controlled financial institution. The 10 per cent limitation on any individual shareholder resident or non-resident will continue to be applied to the larger banks. United States bank subsidiaries in Canada will be exempted from the current 16 per cent ceiling on the size of the foreign bank sector.

Financial institutions, other than insurance, are not covered by the dispute settlement procedures of the Agreement. Rather, these consultations will take place between the Canadian Department of Finance and the United States Department of the Treasury. Significant areas of financial services regulation in Canada (e.g. stock exchanges) are regulated provincially. Liberalization of these activities has been moving far ahead of the FTA with the advent of global financial/securities markets.

The preference for United States and Canadian nationals in each other's markets create a new discrimination against third-country nationals in this important area.

F. Institutional provisions

Part Six contains both the general dispute settlement provisions and the special arrangements for dealing with anti-dumping and countervailing duties.

1. Dispute settlement

Chapter Eighteen of the FTA relates to bilateral disputes. Generally, it does not impact adversely on third countries. It is a bilateral substitute for articles XXII and XXIII of the General Agreement. The principal difference is that under the bilateral procedures the Parties are

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FTA only dealers unaffiliated with a bank could underwrite securities of Canadian banks and their agents in the United States.

prepared to be bound by the results of a dispute settlement Panel through binding arbitration when they agree to such arbitration in advance. In the case of safeguard measures, binding arbitration is automatic. We know from recent experience in the GATT[53] that they do not always adopt the same approach to the results of GATT Panels. The latest ploy used by both countries is to agree to adoption of a report and then indicate that they will seek resolution in the context of the Uruguay Round. Unfortunately the sugar dispute (United States) and dairy products (Canada) are both agricultural issues. The parties will be looking for concessions from others before agreeing to phase out the offending practices.

Chapter Eighteen provides for:

- Mandatory notification of any measure which might materially affect the Agreement;[54]
- Mandatory provision of information to the other party on any measure, whether or not it has been notified;[55]
- Consultations at the request of either party concerning any measure of any other matter which effects the operation of the Agreement with a view to arriving at a mutually satisfactory resolution;[56]
- referral to a Canada-United States Trade Commission, should resolution through consultations fail;[57] and
- Use of dispute settlement procedures should the Commission fail to arrive at a mutually satisfactory resolution. Procedures are:

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[53] Dispute cases involving complaints by the United States against Canada relating to customs fees and sugar, and by Canada against the United States relating to ice-cream and yoghurt, salmon, and herring.

[54] Article 1503.

[55] Article 1803.

[56] Article 1804. Parallels article XXII of the General Agreement.

[57] Article 1805.

(1) compulsory arbitration, *binding on both parties*, for disputes arising from the interpretation and application of the safeguards provision;[58]

(2) binding arbitration in all other disputes[59] where both parties agree; and

(3) panel recommendations to the Commission, which, in turn, is mandated to agree on a resolution of the dispute.[60]

There has been only one dispute to date under Chapter Eighteen where a Panel has been reported - relating to salmon and herring which had earlier been the subject of GATT article XXIII Panel finding unfavourable to Canada. The Panel finding appeared to be an attempt at conciliation rather than judgement. This approach is not likely to sit well with United States interests who have addressed the question of rights and obligations under trade agreements in a highly legalistic manner.

The Chapter Eighteen process relates only to bilateral disputes. This chapter will have no adverse impact on third countries. An important benefit for the parties will be the prompt resolution of disputes. These provisions do not exempt Canada from the threat of application of Section 301 of the United States Trade Act of 1974.

2. Anti-dumping and countervailing duty cases

Each country retains its right to apply its anti-dumping and countervailing duty systems against the other party. In Chapter Nineteen of the FTA, Canada and the United States agreed to the development over a five- to seven-year period of mutually advantageous rules governing government subsidies and private anti-competitive pricing practices (read as dumping), which are now controlled through the unilateral application of countervailing and anti-dumping duties.

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[58] Article 1103.

[59] Article 1806.

[60] Article 1807.

It was Canada's central stated objective in the FTA negotiations to secure a *de facto* exemption from United States trade laws. The focus of the negotiations was on subsidies and countervailing duties. A continuing Canadian objective is to try to develop a definition of subsidy which will insulate Canadian exports from United States countervailing duty. There are particular concerns in Canada about losing the possibility to provide financial assistance to encourage regional development and to reduce regional disparities. In Canada, government financial assistance has been a more common way of judging industrial development than it has in the United States. Some United States Senators are opposed to authorizing or legitimizing any trade-distorting measures. Section 409(b) provides a process for identifying industries that are likely to face "increased competition from subsidized imports from Canada or other countries designated by the President with which the United States concludes future trade-liberalizing agreements." Section 409 of the United States implementing legislation requires that in the bilateral negotiations special emphasis be given to disciplining those Canadian subsidies affecting United States industries that directly compete with subsidized imports.

This provision was drafted as an interim measure to respond to Congressional concerns that certain industries, including the non-ferrous metals industry, are likely to face increased subsidized competition as a result of the sweeping removal of trade barriers that now limit Canadian access to the United States market. Since it is an interim procedure, if rules and disciplines to control subsidies are developed, use of the procedure should be terminated.

Section 409(b) enables an industry to petition the Trade Representative for identification, based on whether the Trade Representative, in consultation with the Secretary of Commerce, considers that there is a reasonable likelihood that the industry:

(1) may face increased competition as a result of implementation of the Agreement from subsidized products imported from Canada with which the industry directly competes, or faces such increased competition from directly competing subsidized products of other countries designated by the President, after consulting with the

Congress, as benefitting from a reduction of trade barriers under agreements entering into force after 1 January 1989; and

(2) may experience a deterioration of its competitive position before rules and disciplines on subsidies have been developed with respect to such country.

At the request of an identified industry, the Trade Representative must compile information in accordance with section 305, recommend that the President request the USITC to undertake a section 332 investigation, or both.

At the request of an identified industry, the Trade Representative will (1) make available to the industry information under section 305; and/or (2) recommend to the President that the USITC be requested to investigate pursuant to section 332. In preparing reports as a result of this section under section 305 and section 332, the Trade Representative and the USITC, respectively, in consultation with the Department of Commerce, will expeditiously obtain information on the subsidy programs (including their terms and conditions) and their impact upon the identified industry. If a government fails to respond fully to the Trade Representative's request for information under section 305, the Administration may draw adverse inferences.

Information collected pursuant to this section may well be useful in international negotiations concerning subsidies and, in the case of information concerning Canadian subsidies, would be provided to Working Group to help expedite progress in that Group's tasks. Of course, any unclassified publicly available information compiled under section 305 or included in a USITC report under Section 332 would be available to industry for its own use, including use for filing a petition under section 301 or the CVD law.

Once an industry is identified and information is obtained, section 409(b) of the bill requires the Trade Representative and the Secretary of Commerce, in consultation with the industry, to consider whether any action is appropriate under section 301 or the CVD law, respectively. Except under extraordinary circumstances, it is expected that neither a section 302 investigation (by the Trade Representative) nor a CVD investigation (by the Department of Commerce) will be self-initiated as a result of this section without the consent of the industry concerned. Any determination to initiate an investigation pursuant to section 302(c) will be treated as an affirmative determination under section 302(b)(2).

In determining whether action is appropriate under section 301 or the CVD law, the Trade Representative and the Department of Commerce, respectively, will consider whether the subsidy programs at issue are having or are likely to have a significant negative impact upon the identified United States industry. In addition, in determining any retaliation following a section 301 investigation initiated as a result of section 409(b), the Trade Representative will give preference to retaliation on products that benefit from the subsidy programs that are subject to the section 301 investigation, unless retaliation on other products would be more effective.

This provision is consistent with the FTA, under which countervailable subsidies are normally to be dealt with by the countervailing duty laws of each country and final determinations under those countervailing duty laws will be subject to binational panel review under Chapter Nineteen of the Agreement. The administration does not intend to use section 1 for the purpose of circumventing the countervailing duty and Chapter Nineteen procedures.

These efforts bear watching, but nothing has been done yet so there is no cause for third-country complaint. The question that arises is whether XXIV envisages differential rules for defining subsidies or allocating benefits as between countries inside and outside a Free Trade Area.

On the anti-dumping side, some Canadian officials seem to consider that the issue of discriminatory pricing within the Free Trade Area should be addressed by the use of competition laws. There is also a presumption or assumption that once duties are removed there will no longer be a need nor an incentive to dump. The authors feel that there are many reasons which may lead to dumping, other than the intention to overcome a tariff. However, anti-trust legislation has different standards and defences, and would, on balance, probably liberalize trade. The Canadian approach raises a question which the EC successfully raised in respect of patent infringement. If there are domestic laws to address internal price discrimination why should the same standards not apply to international price discrimination? Here too, nothing has been done, so there is no cause for third-country complaint.

The Chapter provides for bilateral review of any changes in existing countervailing or anti-dumping laws and regulations for consistency with the GATT and the object and purpose of the Agreement. The most interesting part of this change is that amendments to United States anti-dumping and CVD law no longer apply to Canada unless Canada is specifically named in the change.[61] There are no changes to address at this time - the changes in the 1988 United States Omnibus Trade Act do apply to Canada because the FTA had not yet entered into force. This rule could create a double standard.

The agreement also replaces the current system of judicial review by domestic courts of countervailing and anti-dumping final orders by a bilateral panel. This procedure is now working. In the first case, *red raspberries from Canada*, the Department of Commerce findings of dumping against threat of three exporters were remanded to DOC for further comment and explanation. The Panels are largely staffed by specialist practioners in the anti-dumping countervail area. Extensive use of the Panel proceedings have been made to date. They are less expensive and more expeditious than judicial review in the Courts. The results remain to be seen. It is interesting that the United States Statement of Administrative Action attached to the Implementing Legislation notes:

> Binational panel and Committee determinations are not intended to effect any change on the substantive law *or to provide any benefits to importers of goods from third countries*. (Emphasis added.)

Thus the bill makes it clear that panel and committee determinations do not constitute binding precedent on United States courts. This gives rise to the question as to how this legislation can be applied differently to Canada than to the rest of the world.

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[61] Canada tends to read more into this provision than the United States. Canadian negotiators claim it is an exemption from changes in United States law unless Canada is specifically named in the change. The United States Statement of Administrative Action notes that the new provision requires an amendment to specify application to the goods of the other party where this is intended.

G. Other provisions

Chapter Twenty of the FTA contains a range of miscellaneous provisions. Some deal with specific issues (such as intellectual property or cultural industries) or address an existing irritant in bilateral relations (such as cable retransmission rights) while others establish a general rule which affects the application of other chapters in the Agreement (such as balance-of-payment measures or the treatment of monopolies).

From the beginning of the negotiations, Canadians expressed concern that an agreement might erode the government's capacity to encourage and help Canada's cultural industries (film and video, music and sound recording, publishing, cable transmission and broadcasting). The two Governments agreed in article 2005 on a specific provision indicating that, with four very limited exceptions, nothing in this Agreement affects the ability of either Party to pursue cultural policies. The United States retained the right to respond with measures of commercially equivalent effect.

By virtue of article 2002, the FTA also leaves the parties free, to the extent permitted by article XII of the General Agreement, to impose restrictions in order to safeguard their balance of payments positions. Article 2003 governs the extent to which a party may take action that would otherwise be inconsistent with the FTA in order to protect its essential security interests. The article does not apply to actions related to trade in energy products or to measures related to government procurement, since the FTA chapters governing those subjects contain their own national security exceptions. Under article 2004, the parties are pledged to work together in the current GATT round and in other international fora to improve protection for intellectual property. This was the extent of the agreement possible in the bilateral negotiations. The only other intellectual property issue was the agreement on the part of Canada to pay for cable t.v. transmission rights (stations had been pirating the United States signal).

Article 2007 eliminates a Canadian requirement that a magazine or newspaper be printed in Canada in order for advertisers in that publication to deduct the cost of such advertisement for Canadian income tax purposes. Article 2008 addresses the issue of the sale in Canada of US-made construction grade plywood. Under the terms of that article, the pursuant to an exchange of letters on the subject, the parties agreed that the Canada Mortgage and Housing Corporation (CMHC), by 15 March 1988, would evaluate United States "C-D grade" plywood to decide whether to approve its use in the construction of housing that the CMHC finances. In the event that the CMHC did not approve such use, a panel of experts acceptable to both parties was to review the findings and evaluation of the CMHC.

Article 2010 governs the operation of governmentally created or regulated monopolies operating in markets for goods or services covered by the FTA. (Article 5 of Annex 1404.C establishes similar, specific obligations for regulated monopolies operating in the network-based enhanced telecommunications markets.) Paragraph one establishes that a party may freely maintain as existing monopoly, or designate a new one, subject to the "nullification or impairment" provisions of article 11. Paragraph two sets out consultation procedures to be followed prior to the designation of new monopolies. The final paragraph obliges each party to ensure that the monopolies that it designates in the future do not engage in trade-distorting practices in their monopoly markets or in anti-competitive practices in other markets, to the detriment of persons of the other party. Article 2011 addresses cases in which a party takes action that, even if not inconsistent with any of its specific obligations under the FTA, nevertheless causes "nullification or impairment" provisions of the Agreement. The provision is derived from the provisions of, and practices under article XXIII of the General Agreement.

II. THE CANADA-UNITED STATES TRADING RELATIONSHIP

Canadian trade officials and politicians often state that the FTA is the most comprehensive trade agreement ever concluded between two countries, covering not only trade in goods but trade in services, investment, and the movement of individuals.[62] It builds upon GATT commitments and a patchwork of bilateral arrangements and *ad hoc* understandings; and expands them into a broad agreement to govern the economic relationship of the two countries for the foreseeable future.

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[62] The FTA does not cover all services and it does not cover movement of all peoples.

In the authors' opinion, the true impact of the FTA on third countries must commence with an understanding of the nature of Canadian-United States trade patterns which were in existence prior to the signing of the FTA.

1. The Canadian and United States economies have become increasingly integrated since the 1960s.

Canadian and United States tariffs have been gradually lowered over the past four decades through free trade in agricultural implements, seven rounds of GATT negotiations, the Defence Production Sharing Arrangement (ensuring virtual free trade in defence material and equipment) plus the 1965 "Auto Pact" which led to the development of one rationalized North American automotive industry.

The economic integration implicit in pursuing liberalized trade was supported by the free flow of capital between the two countries and massive America direct investment in the Canadian resource and manufacturing sectors. In recent years there has also been a significant flow from Canada to the United States.

In short, the *FTA can be seen as a belated public policy response to the existing reality of an integrated Canada-United States economy.*[63]

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[63] This public policy response has not been received with unanimous enthusiasm. Political and economic observers are split into two camps. One, favouring the Agreement, sees it as a means of defusing trade frictions between Canada and the United States. The other school favours improving Canada's trade relations with third countries and diversifying trade to reduce economic dependence on the USA. Known as the "third option" this approach was pursued by Canada from shortly after the August 1971 "Nixon Shock" (with limited success) until the beginning of the FTA negotiations.

2. Cross-border regional markets are different.

The overwhelming bulk of Canada-United States trade occurs within the Great Lakes area.

Fully two-thirds of all Canadian exports to the United States (and virtually all its manufacturing exports) come from the region of Canada which borders the Great Lakes (Southern Ontario and the Montreal Region).

Nearly half the two-way trade between Canada and the United States flows within this region with the major product being trade in transportation equipment under the Auto Pact.

In the West and Atlantic regions of the continent, the Canada-United States relationship is more traditional, with Canadian and natural resources flowing to the more populous US market. In the East, principal Canadian exports include fish and agricultural products, non-ferrous metals, forest products and energy (electricity). In the West, 70 per cent of Western Canadian exports flow to 12 states, with the principal exports being oil and gas, uranium, livestock and meat, forest products and potash (fertilizer for the United States corn belt). If one examines the FTA economy from a regional perspective, it is interesting to note that California forms the largest economy on the continent, followed by New York State, Canada and Texas.

Canada enjoys a large merchandise trade surplus with the United States Great Lakes states, with Ontario's surplus in automotive trade essentially paying for Canadian deficits in other manufactured products. Two-way trade with the other growing regional markets such as California or the Texas/Florida Gulf region is much smaller, though Canada remains one of the best foreign customers in relative terms. For example, trade between Canada and California amounted to approximately $6 billion, with Canada running a $1 billion deficit. Two-way trade betwen Canada and the central sourthern United States region centred in Texas totals approximately $4 billion, with Canada running a small deficit. As well, the composition of trade is between

Canada and Texas, chiefly Canadian raw materials for Texas manufactures.[64]

3. A few large firms account for the bulk of Canada's trade with the United States.

Some 15 firms account for 70 per cent of Canada's trade with the United States. These include: the Big Three Auto makers (GM, Ford, Chrysler); IBM and other office equipment multinationals; Alcan Aluminum; Dofasco and Stelco (steel); Inco and Noranda (mines); and four forest product companies.

4. Canadian-United States trade is increasingly complementary and not competitive.

Consistent with the dominant role of multinational companies in Canada-United States trade, Canada-US trade is increasingly characterized by the exchange of complementary goods, rather than competitive ones. The Auto Pact is the central reason for this shift. After 20 years of tariff-free organization of auto production in North America, certain types of cars are made in Canada for North America and certain other models are imported.[65] Such a rationalization has also occurred in other manufacturing sectors at both the component and end product level. *The result is that fully 75 per cent of trade in manufactured products is non-arms-length intra-firm transfers* and the rules of origin in the FTA as well as tariff elimination schedules are designed to benefit these firms at the expense of their competitors.

The FTA can therefore be perceived as a means to remove border barriers which impeded this rationalization process. As such, it is correctly seen as a *means to improve the competitiveness of North American firms against third country competition, in the same way that*

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[64] Source: Department of External Affairs and International Trade, Canada.

[65] The Auto Pact companies can and do import free of duty from third countries but while this benefits third country auto producers - it ties them into the distribution marketing systems of the North American BIG THREE automakers.

the European 1992 exercise is meant to bolster European international competitiveness.

The complementary nature of Canada-United States trade inherent in the concept of non-arms-length intra-firm trade is also present in certain traditional relationships in the resource sector. For example, American East Coast cities and industries welcome electricity exports from Quebec and New Brunswick. Canadian pulp and paper is used by metropolitan newspapers in Chicago, New York and throughout the United States. Saskatchewan potash and uranium is sought by United States farmers and nuclear-powered utilities. And Western Canadian oil and natural gas find a ready market in the United States.

The result of rationalized manufacturing production and the United States need for certain Canadian resources *was relatively few border barriers or irritants in a significant portion of Canada-United States* trade prior to the signing of the FTA, making the Agreement as much a codification of the existing reality and a preventive measure as a trade-liberalizing measure.

5. High MFN tariffs aimed primarily at third-country imports.

The tariff has been an important but waning import-policy instrument in Canada and the United States for many decades. More than 75 per cent of Canada-United States trade now moves free of duty. This figure, however, fails to take account of the trade which could take place but for tariffs. High United States tariffs - 15 per cent and more on petrochemicals, metal alloys, clothing and many other products have continued to pose serious barriers to the United States market for Canadian exporters and prevent Canadian firms from achieving the economies of scale on which increased competitiveness and employment in Canadian industry depend. In addition to high tariffs, escalating tariffs on resource-based products discouraged the development of more sophisticated manufacturing in Canada. While a 1.7 per cent kilo tariff on zinc ore may not impose a significant barrier, a 19 per cent tariff on zinc alloy has effectively retarded the establishment of a zinc metal fabricating industry in Canada.

The reduction of escalating United States tariffs has long been an objective of Canada in successive multilateral rounds. While the United States has been sympathetic, particularly given the level of American ownership in some affected Canadian industries, United States concerns over third-country imports (for example, Saudi petrochemicals) have caused the United States to refuse to grant such relief on an MFN basis. The preferential nature of an FTA has therefore allowed the United States to meet longstanding Canadian trade objectives.

In Canada, tariffs on certain sectors have remained even higher than in the United States. Furthermore, a greater percentage of these tariffs have been maintained with United States competition in mind. The decision to eliminate all tariffs over the nine-year period is therefore a cause for greater adjustment in those sectors which have relied on the domestic market alone (e.g. textile and apparel, footwear, etc.). In short, the impact of the FTA on the American economy is negligible in a relative sense. *It is the Canadian economy where the change will most be felt in both a positive and negative sense.* Hence the bias in the following sectoral analysis towards the Canadian market impact.

III. SECTORAL IMPACTS

A. General features

The FTA will have both positive and negative impacts on third countries. The potential positive impact of the FTA on third-country trade and investment patterns can be predicted on the basis of three general features.

In the first place, improvements in the general economic welfare should lead to increased consumer spending, including on such products as clothes and footwear, on cars and light trucks as well as on entertainment and leisure products such as video and audio equipment. These are macro-benefits - which should flow to efficient suppliers.

Secondly, improvements in productivity and competitiveness, including through increased specialization, should lead to increased two-way trade. For those components or finished products where

Canadian producers are not competitive or do not believe they can become competitive, there will be increased opportunities for both United States and third-country suppliers. However, the potential sales of third countries will be limited by the very tight FTA rules of origin. While United States suppliers will have an initial advantage due to the removal of barriers to their exports, once the products are no longer made in Canada, the rationale for protection will disappear and the Canadian Government may be amenable to requests to reduce or eliminate tariffs on an MFN basis, particularly if these requests are matched by offers of reciprocal concessions of interest to Canadian industry.

Thirdly, "neutral" market forces are causing more and more producers to locate final assembly of *finishing* facilities in either Canada or the United States to ensure the ability to serve the market from a more secure and more customer-sensitive base. However, once again the rules of origin and other aspects of the agreement will ensure that in most assembly operations, there will be a minimum 50 per cent of direct cost of processing incurred in North America, which means an even higher percentage of parts and materials will have to be sourced in North America.

Whatever general or macro-economic argument may be put forward about the trickle-down benefits to third countries, the FTA must be seen for what it is - an agreement in which Canada and the United States extend preferences to each other which discriminate against those outside the FTA.

- The FTA is clearly designed to promote the competitiveness of North American firms vis-à-vis third-country competition.

- It creats a preferential tariff advantage for Canadian and United States firms against their third country competition and will over time make the red tape of border crossings unravel.

- It acts to encourage direct investment in North America rather than exports through the rules of origin which maximize FTA content - a trend already underway in this era of just-in-time inventory and close customer-supplier relationships.

- Further, it lessens the need to avoid the erection of non-tariff barriers to cross border trade by increasing the ability of each party to exempt the other from global actions. On the other hand it may make it easier to invoke selective safeguard action.

B. Sectors

1. Textiles and apparel

Canada and the United States restrict textile and clothing imports from developing countries under the Multi-Fibre Arrangement (MFA). The United States is the largest supplier of primary textiles to Canada. The tariffs on textiles are among the highest in the Canadian schedule. While phased elimination will take 9 years until 1 January 1998, the preferential removal of textile tariffs will benefit the United States at the expense of third countries. Take this together with the double transformation rule of origin and the system is restrictive indeed.

Canadian apparel manufacturers have been increasingly turning to offshore fabrics for market differentiation in more fashion-oriented segments of the clothing market. However, the FTA limits the ability of Canadian apparel manufacturers to source offshore fabrics through the so-called double transformation rule of origin, which sets an FTA rate quota for 50,000,000 SYEs for Canadian apparel using third-country fabrics (other than wool) and 6,000,000 SYEs for wool. Some room for growth does exist to the extent that the growth contemplates growth over current export levels. As noted earlier, ex-quota apparel would be eligible for drawback on the MFN fabric rate.

Drawback is retained for non-FTA apparel, but these garments must move over some very high tariffs - in the 30 per cent range. The Canadian Government has instructed the Canadian International Trade Tribunal to review the possibility of reducing Canadian tariffs on fibres, yarns and fabrics against third countries to levels more in line with rates in the United States, Japan and EEC. This could result in a reduction of 26 per cent or more in these tariffs.

As for apparel, third-country costs are generally much lower than the costs which apply in Canada or the United States. Removal of tariffs will not have an impact commensurate with the disparities which will exist. Of potential concern is the FTA terms regarding the selective use of safeguards. To the extent the Uruguay Round negotiations succeed in reintegrating textile and apparel trade into the General Agreement, the FTA selectivity rules suggest that developed countries would seek to use safeguard actions to continue protection in sensitive sectors. However, the United States and Canada are not major suppliers of wearing apparel to each other's markets.

In summary, third-country fabric producers should benefit from lower Canadian tariffs which have been reduced as a result of the FTA, at least until the tariff-rate quota is filled. On the other hand, there is an incentive for Canadians to use United States fabrics in less fashion-oriented garments. The FTA should have little impact on United States third-country relations or trade patterns.

2. Steel and other metals

In recent months the United States has become a more important supplier of steel to the Canadian market at the expense of third countries. This is due to a strengthening of the Canadian dollar and a reluctance on the part of Canadian steel producers to file trade actions against the United States. Canada is not included in the United States-VRA system but the industry appears unwilling to increase their sales to the United States to above 3 per cent of imports. *De facto* they will not, for the near term, take advantage of their access to the United States.

The rules of origin in the FTA, while not going as far as "melted and poured", are designed to encourage the use of Canadian or United States steel in a wide range of end products. In terms of United States steel, it should have a significant impact on their relations with third countries.

While much of the aluminium industry relies on domestic resources, Canada's abundance of hydro-electric power has resulted in a world-scale aluminum industry, using Guyanese, Jamaican, Australian and Chinese bauxite and alumina. There has been rapid FTA elimination of tariffs in some areas. Asian and Pacific markets are also an important outlet for the production of primary Canadian minerals and metals, particularly copper and coal exported to Japan.

There are investment opportunities for third countries in Canadian resource development. At the level of raw materials there will be little change in access to the United States markets. Removal of tariffs on semi-fabricated and fabricated products, together with the requirements of the origin rules will provide a substantial advantage to Canadian producers. These rules of origin will merely supplement the extensive use of countervail and anti-dumping rules and voluntary restraint agreements which currently act as the means to manage import levels in North America. *The principal beneficiaries should be Canadian alloy refiners at the expense of United States production.*

In the past decade, the steel industry has invested some $10 billion in new facilities and in upgrading existing technologies. Estimates are that the steel industry will need to invest another $5 billion by the mid-1990's if it is to maintain its competitive position in the North American market. In the upgrading now nearing completion, Japanese technology and investment played an important role. Japan has developed the most sophisticated continuing casting techniques which will be central to further upgrading of Canadian steel mills. The anticipation is that the Canadian industry will be seeking technology transfer arrangements with steel producers in Japan and Republic of Korea and a share of the capital required from Asian and Pacific sources.

3. Footwear

Asian developing countries have a significant presence in the Canadian footwear market. In 1987 they supplied the Canadian market with some 65 million pairs of shoes. Most of these originated in Taiwan, Republic of Korea, Hong Kong and China. With the removal of the global quota on imports in 1988, there appeared to be good future prospects. The FTA is expected to increase adjustment pressures on the Canadian footwear industry and, coupled with the lifting of global restraints, lead to a smaller, more specialized and more competitive Canadian footwear industry. The FTA also helped on the input side through fast removal of tariffs on leather. A recent imposition of significant Canadian dumping duties on Asian footwear could cause a change in sourcing patterns among low-cost countries. While the Canadian ability to increase exports to the United States will be important for the individual companies, success would have negligible impact on the United States industry.

4. Petrochemicals, synthetic resins and plastics

The Canadian petrochemical, synthetic resin and plastic industries afford a good example of a related group of industries in which forward and backward linkeages are expected to reinforce the positive impact of the FTA. The three groups of industries together employ 68,000 people and produced some $12 billion in shipments. Forward and backward linkages to other industrial sectors make this group of industries a key part of the Canadian industrial structure. They have unsuccessfully argued for more rapid removal of tariffs.

Canadian producers of petrochemicals are expected to perform well under the FTA. Canadian petrochemical production, excluding fertilizers, amounts to approximately $6 billion annually with product sales in the range of $5 billion. Exports constitute approximately $2 billion of which about 60 per cent are destined for the United States. Imports are at a similar level accounting for about 40 per cent of domestic end-product consumption.

The Canadian and United States tariffs on petrochemicals will be eliminated over a five-year period (with many items to be eliminated 1 April 1990) as a result of the first round of acceleration discussions. Lower costs for imported materials, together with more open and secure access to the large United States market will enable the Canadian petrochemical industry to improve its productivity by an estimated 3 per cent by 1998. All major petrochemical producers have announced plans to expand their facilities in Canada, citing both the elimination of the tariff and increased security of access as key elements in their future marketing strategy.

Synthetic resin producers, the next step up the chain, are also expected to do well. Most are competitive in Canada and in the midwest and northeast regions of the United States as well as vis-á-vis Japanese and European suppliers. The industry is, as a result, heavily integrated into international markets. In 1986, 46 per cent of shipments were exported and 53 per cent of domestic requirements were imported; 16 per cent were shipped to Asian customers while less than 2 per cent were supplied by Asian sources. Elimination of tariffs of 9 to per cent on imports and 6 to 12 per cent on exports as a result of the FTA will encourage the industry to improve operations through increased rationalization of products, facilities and overheads and through restructuring and incremental expansions of capacity.

The third step up the chain, plastics, are also expected t0 benefit from free trade, but to a lesser extent. Current levels of tariff protection- from 8.4 to 13.6 per cent - and competitive suppliers have allowed the plastics industry to dominate the domestic market. In 1986 18 per cent of shipments were exported and 27 per cent of domestic requirements were imported. The Asia-Pacific region accounted for 2 per cent of both exports and imports. The FTA will require some major adjustments in the industry and cause it to become more specialized and cost-competitive. It will, at the same time, allow the export-oriented segments to grow as it no longer faces tariffs of up to 8 per cent. High demand for the industry's products will likely allow the industry to make the necessary adjustment and result in a more competitive industry.

There is widespread agreement that the FTA will significantly improve investment opportunities in Canada to supply the North American petrochemical and derivative markets. Canada is in an excellent location to service both North American and offshore markets because of Canada's abundant energy reserves, world-competitive plants, highly experienced work force, advanced research and development capabilities and reputation as a stable and reliable supplier.

5. Furniture

The Canadian household furniture sector is expected to face major adjustment as a result of free trade, particularly because tariff protection of 12 to 15 per cent will be eliminated over a period of five years and will erode the industry's dominant position in the domestic market. This will be somewhat offset by the elimination of tariffs on inputs such as hardware (10.2 per cent), particle board (6 per cent) and upholstery fabrics (15 per cent),[66] placing competitive pressures on domestic suppliers. Most furniture is price, tariff and transportation-cost sensitive. Imports, as a result, are concentrated in the expensive high-end or inexpensive, light low-end.

The Canadian household furniture sector is dominated by small, family-owned firms supplying regional markets. The introduction of more competition from larger and better organized United States producers will force these firms to become more efficient and specialized by employing more modern technology and production methods and longer production runs. Some firms that have already made the transition have found that they can successfully market their product in the northern tier of United States.

Imports supply less than a quarter of the household market today, 20 per cent of that supplied by Asian producers of speciality furniture, e.g., rattan from the Philippines. While Canadian and American producers are expected to continue to be the main suppliers of the bulk of household furniture, the increasing mobility of society is expected to increase demand for light and knockdown furniture supplied by Asian producers. The move to a smaller, more specialized domestic industry should also open opportunities for suppliers of knockdown and exotic furniture across the Pacific.

While the household sector will require major adjustment, the Canadian office and institutional furniture sector is expected to be a major beneficiary of the FTA. Two-fifths of production is already exported to the United States and many firms are gearing up for even more United States sales. Office furniture is largely distributed through contract sales where design, quality and the ability to meet customer specifications are as important as price. The elimination of the tariff, therefore, is expected to make less of a difference to this sector. The rates of duty are the same as for household furniture. Nevertheless, while there are a number of highly successful firms, a number of smaller, regionally oriented firms will face stiff new competition and will require significant modernization.

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[66] However, the tariff removal in upholstery fabrics will be slower (9 years) than it will be for furniture (4 years).

Trans-Pacific trade in finished office furniture is currently negligible. Asian and Pacific suppliers of exotic woods and upholstery fabrics will see increased opportunities resulting from increased production of domestic and export consumption by Canadian producers.

6. Computer equipment and telecommunications

The elimination of tariffs between Canada and the United States should result in an even more rationalized and competitive North American computer equipment and telecommunication sector. Much of the trade in these products was MFN or GSP free of duty. The FTA tariff cuts will have little impact but rules of origin will limit the ability of developing countries to develop opportunities in componentry production.

7. Agriculture

Different sectors of North American agriculture are governed by radically different public policy regimes. The Canadian system in some parts is highly regulated by supply management systems.

(i) Grains, oilseeds and meat and livestock

North American grain and meat industry is both market and export-oriented relative to most agricultural sectors. Principal concerns of North American producers have related to third countries, particularly the impact of the European Common Agricultural Policy on the residual global market, with the United States responding to European actions with escalating export subsidies.

While Canadians meat and livestock exports to the United States are substantial, Canadian grain generally flows to third-country markets rather than north-south. The FTA therefore has relatively limited impact on the North American grain trade. The important trade negotiations about the grains are in the Uruguay Round of GATT negotiations.

On the surface, it would appear the FTA could have a negative impact on third-country meat exports to the two countries to the extent the FTA:

- contemplates the selective use of global safeguards and
- limits the degree to which Canadian and United States exports face potential harassment from import inspection laws. The ability to exclude the other party should ease the political dangers which have acted as a discipline on the use of quantitative restrictions.

As a practical matter few developing countries can export meat to Canada for health/phyto-sanitary reasons.

(ii) Dairy, poultry

Canadian policy regulating the dairy and poultry sectors is import-restrictive, based on article XI of the General Agreement. The American dairy sector, like its Canadian counterpart also enjoys protection under the longstanding GATT waiver. The FTA has no impact on third-country exports to these markets. While the successful United States GATT challenge of the Canadian decision to add ice-cream and yoghurt to the import control list has longer-term consequences for the Canadian supply management system the FTA itself avoided disturbing the rules governing these politically sensitive sectors.

(iii) Citrus fruits and sugar

As a northern country, Canada necessarily imports its semi-tropical and tropical fruit needs. The rules of origin have been written to give a preferential advantage to American citrus fruit products used as inputs in processed foods and beverages. The exemption of Canada from potential United States restrictions on sweetened products will make it easier for the United States to tighten further its protective regime for United States producers.

8. Energy

North American energy trade generally flows North to South from Canadian producers to American consumers. Canadian exports of oil, natural gas, coal, uranium and electricity exceed $10 billion per annum, accounting for about 10 per cent of total Canadian exports. The FTA reinforces the ongoing trend towards a greater American reliance on Canadian natural gas and electricity - both forms of energy requiring significant capital outlays in the construction of pipelines and transmission networks. *Some substitution of United States third-country oil imports by Canadian energy can be contemplated.*

Assuming a favourable investment climate, capital expenditures on oil, gas and electricity projects in Canada are expected to exceed $250 billion by the year 2000. Under the FTA, the two Governments have agreed to provide national treatment in future to each other's investors. The potential benefits for third countries are in investment more than trade in goods and services.

Increasing activity in Canada's energy-producing sector as a result of the FTA, will likely impact positively on manufacturers of energy-related machinery and equipment. The FTA is expected to have an impact in lowering the costs of machinery and equipment imported by the energy industry. Republic of Korea has become a very cost-efficient producer of castings for large turbines. They should benefit despite the United States preference.

Although most imported oilfield machinery and equipment is presently produced in the United States, there is production expertise in Japan, Republic of Korea, Province of China, and Taiwan for more standard design equipment. If the major oil reserves discovered in the Beaufort Sea and off the east coast of Newfoundland are developed to meet increased North American demand, there also will be need for a number of oil drilling rigs. These are macro-benefits - for which local suppliers will have a preference.

9. Consumer products

(i) Sporting goods

Canadian sporting goods concerns (e.g. bicycle assemblers) often source Asian parts. To the extent they serve the Canadian market and have no export aspirations, past sourcing patterns may continue. However, if companies do have export aspirations, they may need to source more North American parts to qualify for free trade status, to the detriment of Asian suppliers.

(ii) Toys and games

The Canadian toy market is dominated by United States multinationals with extensive Asian operations. It is unclear to date whether the FTA will have an impact. It appears that the impact will be decreased Canadian assembly facilities.

(iii) Consumer electronics

Hitachi and Sanyo currently assemble t.v. sets in Montreal, using Asian components. The assembly operations are geared to the relatively small domestic Canadian market. These products may not qualify for FTA treatment. It does appear that the FTA alone will affect the market forces which are causing increased production of parts and final assembly in Asia.

(iv) Autoparts

During the past decade, Asian automakers have made significant direct investments in the United States and Canada, partially in response to North American "voluntary export restraints". An increasing number of Asian parts manufacturers have followed their customers inshore. The FTA requires the Asian "transplants" to meet North American content rule in order to achieve duty-free status. This will likely encourage more Asian parts producers to locate inside North America, while increasing the use of North American suppliers by the Japanese and Korean concerns.

10. Services

The FTA contains an important chapter governing the future conduct of tradable services. While this chapter is a major step relative to existing bilateral and multilateral arrangements (or the lack of same) a close examination suggests that the agreement is more a codification of the status quo than a trade-liberalizing measure. Put another way, the agreement is as much a preventative mechanism as a catalyst for trade liberalization. To ensure its safe political passage, the two signatories "grandfathered" existing practices which did not conform to the principle of national treatment.

Sensitive service sectors, such as transportation, the legal and medical professions and government-funded social services (Canadian health care) were also excluded. Three sectoral annexes governing tourism, architectural and data services were also signed, amplifying on the general principles in each sector. Here again, however, it was the degree of prior integration and the similarity of the domestic regulatory regimes which made possible such specific agreements.

The services agreement also reflects the new alliances and patterns of ownership which are emerging in North American service industries, where Canadian and American advertising, public relations, legal and accounting firms have been creating continental and global links to service multinational clients. How does the services agreement impact on developing countries? The FTA provisions on services may not have an immediate effect on developing countries. Nevertheless, the FTA establishes a mechanism for intensified preferential terms of market access for the parties to the Agreement, which has its impact for third countries, particularly developing countries. The developing countries may find the Uruguay Round negotiations on a possible multilateral framework on trade in services a unique opportunity for restricting and pre-empting such discriminatory measures which may have serious adverse effects for them.

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